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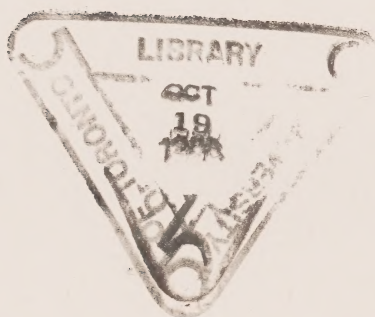
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*The Political Economy of
Economic Adjustment:
The Case of Declining Sectors*

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This volume reflects the views of its authors and does not imply endorsement by the Chairman or Commissioners.





The Political Economy of Economic Adjustment: The Case of Declining Sectors

MICHAEL J. TREBILCOCK

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When the members of the Rowell-Sirois Commission began their collective task in 1937, very little was known about the evolution of the Canadian economy. What was known, moreover, had not been extensively analyzed by the slender cadre of social scientists of the day.

When we set out upon our task nearly 50 years later, we enjoyed a substantial advantage over our predecessors; we had a wealth of information. We inherited the work of scholars at universities across Canada and we had the benefit of the work of experts from private research institutes and publicly sponsored organizations such as the Ontario Economic Council and the Economic Council of Canada. Although there were still important gaps, our problem was not a shortage of information; it was to interrelate and integrate — to synthesize — the results of much of the information we already had.

The mandate of this Commission is unusually broad. It encompasses many of the fundamental policy issues expected to confront the people of Canada and their governments for the next several decades. The nature of the mandate also identified, in advance, the subject matter for much of the research and suggested the scope of enquiry and the need for vigorous efforts to interrelate and integrate the research disciplines. The resulting research program, therefore, is particularly noteworthy in three respects: along with original research studies, it includes survey papers which synthesize work already done in specialized fields; it avoids duplication of work which, in the judgment of the Canadian research community, has already been well done; and, considered as a whole, it is the most thorough examination of the Canadian economic, political and legal systems ever undertaken by an independent agency.

The Commission's research program was carried out under the joint

direction of three prominent and highly respected Canadian scholars: Dr. Ivan Bernier (*Law and Constitutional Issues*), Dr. Alan Cairns (*Politics and Institutions of Government*) and Dr. David C. Smith (*Economics*).

Dr. Ivan Bernier is Dean of the Faculty of Law at Laval University. Dr. Alan Cairns is former Head of the Department of Political Science at the University of British Columbia and, prior to joining the Commission, was William Lyon Mackenzie King Visiting Professor of Canadian Studies at Harvard University. Dr. David C. Smith, former Head of the Department of Economics at Queen's University in Kingston, is now Principal of that University. When Dr. Smith assumed his new responsibilities at Queen's in September 1984, he was succeeded by Dr. Kenneth Norrie of the University of Alberta and John Sargent of the federal Department of Finance, who together acted as Co-directors of Research for the concluding phase of the Economics research program.

I am confident that the efforts of the Research Directors, research coordinators and authors whose work appears in this and other volumes, have provided the community of Canadian scholars and policy makers with a series of publications that will continue to be of value for many years to come. And I hope that the value of the research program to Canadian scholarship will be enhanced by the fact that Commission research is being made available to interested readers in both English and French.

I extend my personal thanks, and that of my fellow Commissioners, to the Research Directors and those immediately associated with them in the Commission's research program. I also want to thank the members of the many research advisory groups whose counsel contributed so substantially to this undertaking.

DONALD S. MACDONALD



At its most general level, the Royal Commission's research program has examined how the Canadian political economy can better adapt to change. As a basis of enquiry, this question reflects our belief that the future will always take us partly by surprise. Our political, legal and economic institutions should therefore be flexible enough to accommodate surprises and yet solid enough to ensure that they help us meet our future goals. This theme of an adaptive political economy led us to explore the interdependencies between political, legal and economic systems and drew our research efforts in an interdisciplinary direction.

The sheer magnitude of the research output (more than 280 separate studies in 70+ volumes) as well as its disciplinary and ideological diversity have, however, made complete integration impossible and, we have concluded, undesirable. The research output as a whole brings varying perspectives and methodologies to the study of common problems and we therefore urge readers to look beyond their particular field of interest and to explore topics across disciplines.

The three research areas, — *Law and Constitutional Issues*, under Ivan Bernier; *Politics and Institutions of Government*, under Alan Cairns; and *Economics*, under David C. Smith (co-directed with Kenneth Norrie and John Sargent for the concluding phase of the research program) — were further divided into 19 sections headed by research coordinators.

The area *Law and Constitutional Issues* has been organized into five major sections headed by the research coordinators identified below.

- Law, Society and the Economy — *Ivan Bernier and Andrée Lajoie*
- The International Legal Environment — *John J. Quinn*
- The Canadian Economic Union — *Mark Krasnick*

- Harmonization of Laws in Canada — *Ronald C.C. Cuming*
- Institutional and Constitutional Arrangements — *Clare F. Beckton and A. Wayne MacKay*

Since law in its numerous manifestations is the most fundamental means of implementing state policy, it was necessary to investigate how and when law could be mobilized most effectively to address the problems raised by the Commission's mandate. Adopting a broad perspective, researchers examined Canada's legal system from the standpoint of how law evolves as a result of social, economic and political changes and how, in turn, law brings about changes in our social, economic and political conduct.

Within *Politics and Institutions of Government*, research has been organized into seven major sections.

- Canada and the International Political Economy — *Denis Stairs and Gilbert Winham*
- State and Society in the Modern Era — *Keith Banting*
- Constitutionalism, Citizenship and Society — *Alan Cairns and Cynthia Williams*
- The Politics of Canadian Federalism — *Richard Simeon*
- Representative Institutions — *Peter Aucoin*
- The Politics of Economic Policy — *G. Bruce Doern*
- Industrial Policy — *André Blais*

This area examines a number of developments which have led Canadians to question their ability to govern themselves wisely and effectively. Many of these developments are not unique to Canada and a number of comparative studies canvass and assess how others have coped with similar problems. Within the context of the Canadian heritage of parliamentary government, federalism, a mixed economy, and a bilingual and multicultural society, the research also explores ways of rearranging the relationships of power and influence among institutions to restore and enhance the fundamental democratic principles of representativeness, responsiveness and accountability.

Economics research was organized into seven major sections.

- Macroeconomics — *John Sargent*
- Federalism and the Economic Union — *Kenneth Norrie*
- Industrial Structure — *Donald G. McFetridge*
- International Trade — *John Whalley*
- Income Distribution and Economic Security — *François Vaillancourt*
- Labour Markets and Labour Relations — *Craig Riddell*
- Economic Ideas and Social Issues — *David Laidler*

Economics research examines the allocation of Canada's human and other resources, the ways in which institutions and policies affect this

allocation, and the distribution of the gains from their use. It also considers the nature of economic development, the forces that shape our regional and industrial structure, and our economic interdependence with other countries. The thrust of the research in economics is to increase our comprehension of what determines our economic potential and how instruments of economic policy may move us closer to our future goals.

One section from each of the three research areas — The Canadian Economic Union, The Politics of Canadian Federalism, and Federalism and the Economic Union — have been blended into one unified research effort. Consequently, the volumes on Federalism and the Economic Union as well as the volume on The North are the results of an interdisciplinary research effort.

We owe a special debt to the research coordinators. Not only did they organize, assemble and analyze the many research studies and combine their major findings in overviews, but they also made substantial contributions to the Final Report. We wish to thank them for their performance, often under heavy pressure.

Unfortunately, space does not permit us to thank all members of the Commission staff individually. However, we are particularly grateful to the Chairman, The Hon. Donald S. Macdonald; the Commission's Executive Director, J. Gerald Godsoe; and the Director of Policy, Alan Nymark, all of whom were closely involved with the Research Program and played key roles in the contribution of Research to the Final Report. We wish to express our appreciation to the Commission's Administrative Advisor, Harry Stewart, for his guidance and advice, and to the Director of Publishing, Ed Matheson, who managed the research publication process. A special thanks to Jamie Benidickson, Policy Coordinator and Special Assistant to the Chairman, who played a valuable liaison role between Research and the Chairman and Commissioners. We are also grateful to our office administrator, Donna Stebbing, and to our secretarial staff, Monique Carpentier, Barbara Cowtan, Tina DeLuca, Françoise Guilbault and Marilyn Sheldon.

Finally, a well deserved thank you to our closest assistants: Jacques J.M. Shore, *Law and Constitutional Issues*; Cynthia Williams and her successor Karen Jackson, *Politics and Institutions of Government*; and I. Lilla Connidis, *Economics*. We appreciate not only their individual contribution to each research area, but also their cooperative contribution to the research program and the Commission.

IVAN BERNIER
ALAN CAIRNS
DAVID C. SMITH



The Political Economy of Economic Adjustment: The Case of Declining Sectors by Michael J. Trebilcock is one of three special studies on the economics of industrial structure conducted for this Royal Commission.

The study begins with an examination of the rationale for government assistance toward declining sectors. Professor Trebilcock concludes that there is both an ethical and an economic efficiency rationale for the subsidization of retraining, geographic mobility and other adjustment costs faced by workers in declining sectors. He also maintains, however, that political considerations militate in favour of indirect, adjustment-retarding assistance in the form of import restrictions or loan guarantees to firms in financial difficulty. The central problem, in his view, is one of structuring the public policy process so as to produce adjustment policies that are closer to his ethical and economic efficiency ideal.

Professor Trebilcock then examines the general and sectoral adjustment policies of the Government of Canada and finds that these policies tend to reflect political, more than economic and ethical, considerations. Both the general programs and the sectoral programs for the automotive, textile, clothing, footwear, tanning, shipbuilding and Cape Breton coal industries have deflected, apparently by intention, the forces leading to economic adjustment. The effects of direct labour-adjustment assistance have been overwhelmed by import restrictions and various subventions to ailing firms.

An analysis of the general and sectoral adjustment policies of six other nations reveals that the policies of three countries, the United States, the United Kingdom and Australia, tend to resemble those of Canada in their emphasis on the preservation of the economic *status quo* by means of trade restrictions. The adjustment policies of West Germany, Japan

and, to a lesser extent, France are closer to Trebilcock's economic and ethical ideal. Trebilcock has particularly high regard for West German policies, which are characterized by an emphasis on labour instability and retraining.

Professor Trebilcock notes that the countries which have attempted to facilitate, rather than retard, economic adjustment have also achieved better macroeconomic performance over the last 20 years. He suggests that the ability of a national government to adopt adjustment-facilitating policies is enhanced by the existence of: a centralized policy-making apparatus insulated, to a degree, from political pressure; broadly-based political interest groups; and a high degree of integration between banks, firms and the government. At the operational level, Professor Trebilcock also suggests a number of improvements in existing Canadian industrial adjustment policies.

This study stands as a major contribution to the international literature on industrial policy. Professor Trebilcock is to be commended for the wealth of institutional detail he has assembled and for the insight shown in his interpretation of it.

D.G. MCFETRIDGE

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None of the foregoing is to be taken as necessarily agreeing with all or any of the opinions expressed in this study.

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MICHAEL J. TREBILCOCK



Barriers to Economic Adjustment

Introduction

Throughout 1984, the United Kingdom was embroiled in a coal miners' strike, marked by bitterness and violence, over proposals by the government-owned National Coal Board to close down 20 uneconomic pits and terminate 20,000 jobs. The steel riots in Paris in early 1979, over proposals to phase out production and jobs in regions with obsolete plants were a similarly extreme reaction to the prospects of economic change. Both events are in some ways reminiscent of the Luddite movement in early 19th century England, protesting technological unemployment induced by the industrial revolution. The similarity of public concerns over the span of almost two centuries is striking. As the Royal Commission on the Economic Union identified the overriding public policy issue in *Challenge & Choices*: "How can we better manage and adjust to change? If there is a single major concern among Canadians, it relates to that question" (Canada, 1984, p. 27).

In the deep economic recession in which most major industrialized Western economies found themselves during the late 1970s and early 1980s, a policy theme that has commanded an increasing number of proponents in many countries, but especially in the United States and Canada, has been the need for government to develop a more concerted industrial strategy. This upsurge in interest in industrial strategies is probably a function of several factors: a growing concern that the recession has not been simply a downturn in the business cycle, but rather a reflection of long-term structural weaknesses in the economy that in turn reflect permanent changes in international terms of trade; a growing disillusionment with the capacity of macroeconomic policies. Keyne-

sian and monetarist, to induce stable rates of economic growth; a recognition that the concept of comparative advantage in international trade is a dynamic phenomenon which can be significantly influenced by public policy, rather than a static notion of relative natural endowments; related widespread belief that the "miracle" economies of the last two decades or so, those of Japan and, to a lesser extent, of West Germany, owe part of their success to the adoption of concerted industrial policies. While the specific elements of an industrial strategy in a U.S. or Canadian context vary widely among proponents, prominent mention is commonly made of the importance of industrial "restructuring" or "positive adjustment." While, again, the details of policies directed to these ends are often vague, in more general terms what seems to be envisaged, for the most part, is the evolution of a set of public policies that will facilitate the movement of resources out of declining sectors into growing sectors — abandoning "losers" and endorsing "winners." On its face, of course, it makes axiomatic good sense to espouse policies that support winners rather than losers.

The primary purpose of this study is to examine why nations find it difficult in practice to adopt and maintain policies of "positive adjustment." We therefore review both Canadian and comparative experience. Essentially, the perspective we have adopted in this study is a "public choice" or "economics of politics" framework in which we analyze political constraints on economically desirable forms of adjustment. The principal focus will be on policies toward declining industrial sectors and the exit of resources from such sectors. We recognize, of course, that an obvious strategy for facilitating the movement of resources out of declining sectors and reducing the costs of such movement is to nurture rapid expansion of other sectors into which the redundant resources can readily move. However, to address fully in a single study both "decline"-oriented policies and "growth"-oriented policies would require an extended analysis of all aspects of industrial policy. Thus, in order to provide a tractable focus for the study, we have considered in any detail only growth-oriented policies directly justified in terms of their impact on declining sectors.

The Public Choice Framework

In capitalist democracies, individual citizens function within economic and political systems with very different properties. As Okun (1975, p. 32) puts it: "The anatomy of the American economy contrasts sharply with the egalitarian structure of its polity." On the one hand, a market economy differentiates in the returns to unequal natural endowments, unequal economic opportunities, and unequal effort. On the other hand, the political system is ostensibly premised on equal political entitlements and equal access to justice. The pursuit of efficiency in a market economy necessarily creates (and, for incentive reasons, requires) ine-

qualities, while the exercise of political entitlements is likely often to tend in the opposite direction.

Joseph Schumpeter once wrote that competitive markets involve "a perennial gale of creative destruction" (Schumpeter, 1975, p. 87). A well-functioning capitalist economy yielding high rates of economic growth over time requires risk taking, innovation, and dynamic adjustment mechanisms that quickly reallocate resources to higher-valued uses, but also implies, of necessity, a high degree of economic uncertainty and, above all, winners and losers.¹ However, as a society becomes more prosperous by virtue of these economic processes, it may well come to consider that assuming large negative risks is something it can afford to dispense with and hence will vote to establish collective programs that minimize certain classes or risks, such as free public education, health insurance, public pensions, workmen's compensation, unemployment insurance, and welfare programs. These "safety nets" are seen as the mark of a prosperous, civilized, compassionate society and offer the promise of individual or family security that stands in contrast to the risks assumed by citizens in poorer, Third World countries facing a continuous battle for survival against pestilence, disease, famine, malnutrition, starvation, floods, drought, economic and political disorder, and other threats. Thus, collective decision making is frequently directed to reducing risk and enhancing security, the market system to fostering risk taking and concomitant uncertainty. This tension between our economic and political systems has led some scholars to be pessimistic or at least circumspect about the survival of either or both systems. For example, Schumpeter, was sceptical that capitalism could avoid being overcome, over time, by socialist forces driven by our political system. Dan Usher (1981) has recently argued from similar premises that when a democracy assumes the role of politically determining the greater part of most people's income and abandons the market as the principal allocator and distributor of resources, its society is likely to degenerate into a war of all against all, in a constantly shifting coalition of voters and interest groups. At the limit, the consequent attenuation of individual property rights results eventually in a form of anarchy not unlike the Hobbesian state of nature to which formal governments, according to some theories, evolved as a response.

Yet despite these tensions between our economic and political systems and the concerns for their future that they have evoked, the fact remains that no genuine democracy has existed in recent times outside a capitalist economy, and few capitalist economies have existed outside democratic polities (Lindblom, 1977, p. 116). This suggests that viable compromises between the inequalities of the economic system and the equalities of the political system are attainable. Public policies toward declining industries entail a focus on what form such compromises might take.

To develop an appreciation of how economic and political considera-

tions might shape these compromises, however, further exploration of the dynamics of the two systems is required. In a market economy the standard neo-classical paradigm tends to assume that markets adjust instantaneously to changes in costs and supply-and-demand configurations. Resources are reallocated by the invisible hand of the market in response to changes in relative prices and move to wherever they are most highly valued. Thurow (1983) refers (critically) to this conception of the market-clearing mechanism as the “equilibrium price auction market.” But as he points out, it is quite unsatisfactory as an explanation of adjustment processes in many markets. For example, it is difficult to understand, on the basis of this paradigm, why there is such a phenomenon as unemployment. Arguably, everybody could get a job at *some* wage, even if at 50 cents a day, or whatever rate peasants or cloth weavers receive in some Third World countries. Presumably, the unemployed in the industrialized world believe that unemployment is a more attractive option. This, then, remits us to the world of politics — to the world of political forces that led to the evolution of labour unions that favour unemployment over wage concessions, and their approval and encouragement by the State, to the internal political dynamics of labour unions, and to broader political forces that have shaped policies on issues such as minimum-wage laws and unemployment insurance.

Here the public choice view of what incentives shape the behaviour of political agents (as compared to economic agents) needs fuller specification. The economic origins of formal government are often, in a public choice framework, traced to the inefficiencies inherent in unstable property rights in a stateless world. In such a world, the classic “prisoner’s dilemma” problem is seen as pervasive, representing a situation where individuals perceive gains from non-cooperative behaviour, although if everybody behaves non-cooperatively, all end up worse off. Thus, in this world, rather than grow my own food, I am tempted to steal it from my neighbour. He or she, in turn, in view of this threat, will face incentives to divert part of his/her resources and energies to non-productive defensive measures against my depredations or, if these are too ineffective or costly, abandon growing food and perhaps plan to steal food from me or others. I, in turn, in the face of such threats, will be tempted to curtail my food production further or to take costly and non-productive defensive measures. Clearly, it would be in our mutual interests to agree to behave cooperatively rather than uncooperatively, to respect each other’s property rights, and perhaps to engage in voluntary exchanges of these entitlements where gains from scale and specialization make this mutually advantageous. But such cooperative accords must be enforceable. In small, static, homogeneous societies, such as primitive tribes or clans, social conventions and pressures may prove adequate to this task. But as societies become more numerous, more mobile, more hetero-

geneous, more impersonal, the effectiveness of these conventions is likely to become attenuated, and it is probable that individuals will need to turn to an agreed-on third party to define and protect their property rights and to enforce voluntary non-simultaneous exchanges of entitlements (Mueller, 1979, chap. 2). Thus, the apparatus of the formal state begins to emerge (according to this theory, for sound economic reasons). The State, of course, requires a constitution which defines the rules by which it is induced to act, even with respect to its minimal role of defining and protecting property rights and facilitating their voluntary exchange. To play this role, the State requires authority and legitimacy. It is unlikely that all individuals will agree to the appointment of a non-accountable, non-removable dictator, a move which subjects their property rights to the risk of capricious and perhaps coercive or malicious encroachment. Thus, typically, some form of representative and accountable decision-making process emerges, where individual citizens vote for their political agents; hence results at least the partial compatibility between capitalism and democracy. Next the constitution must define the voting rules for individual citizens and the voting rules for the political assembly in which their representatives make decisions on their behalf. Here the complications begin. A rule of unanimity requiring that all individual citizens must agree on some collective course of action is unworkable, even though in theory it replicates the virtues of private voluntary exchanges by ensuring that only courses of action are taken that make everybody feel better off. It does not work, partly because of the transaction costs entailed in securing unanimous consent in larger communities, even if all members act in good faith, and partly because such a rule creates incentives for strategic, non-cooperative behaviour where individuals find it personally advantageous to withhold their consent to some proposed course of action in order to extort for themselves a disproportionate share of the gains from such an action. Each individual under a unanimity rule faces such incentives, and thus the prisoner's dilemma problem reappears in another form. Similar difficulties arise if a more relaxed voting rule obtains for individual citizens, but a rule of unanimity applies to their representatives.

There will be compelling reasons to adopt less exacting voting rules in order to mitigate these problems. These rules will probably apply both to individual citizens and to their representatives, in the form, for example, of simple-majority voting rules at both levels. These appear to reduce both transaction (decision) costs and hold-out problems. But now a different order of problems arises. While with unanimous voting rules, the concern was that minorities might act strategically to exploit majorities, now the concern becomes that majorities will act strategically to exploit minorities, and that the newly created State will not confine its activities to the initial definition of property rights (although this exer-

cise itself is problematic under such a rule), to their subsequent protection, and to the facilitation of voluntary exchanges therein. Instead, it will rearrange entitlements on an ongoing basis in whatever way any majority of voters or their representatives at any point in time find in their own interests. The behavioural assumption made by public choice theorists in this context is that political decision making should be modelled as an implicit market in which voters or interest groups demand policies which they consider will maximize their utility, and that politicians will choose to supply those demands which will maximize their utility. It is assumed that this will enhance their prospects of election or re-election. Thus, individual utility-maximizing behaviour will dominate the process of collective decision making as economics assumes it does in voluntary, arms-length, explicit market exchanges. Thus, policy outcomes are not the result of the disinterested pursuit of some notion of the public or national interest, but are rather the result of an intricate web of implicit, self-interested exchanges among voters, interest groups, politicians, bureaucrats and the media.

In this process, the prisoner's dilemma problem emerges once more where incentives for non-cooperative or coercive behaviour as between some groups of the polity and others may overwhelm the virtues of cooperative outcomes. "Rent-seeking," as it has come to be called in contemporary economic literature, is a direct analogue to theft in the stateless society to which the evolution of a formal state was sought as an answer, and the economic implications are closely similar. This is the fundamental and, for the most part, intractable dilemma for capitalism and democracy. One cannot exist without the other: capitalism requires democracy because any other political system potentially offers less stable protection of property rights; democracy seems to flourish most strongly in some form of market economy because its stress on individual civil liberties seems to require some measure of respect for private property rights.² For example, exclusive state ownership of the press and other instrumentalities of individual expression may make the preferences of the populace subject to gross manipulation by the incumbent political party. Yet the two systems represent constant threats to each other: capitalism threatens to overwhelm equality of political entitlements and influence with inequalities of wealth that may imply disproportionate political influence; democracy threatens capitalism because of the tendency to destabilize private property rights through the exercise of political influence by constantly shifting distributional coalitions of voters and interest groups. In this framework, we shall shortly examine how the political system is likely to respond to demands for trade protection, industrial subsidies, or compensation for transitional costs and whether, in this context, policies might be available that render more congruent the products of the forces that drive our economic and political systems.

The Argument for Government Intervention in Market-Adjustment Processes

In a trade context, the policy issue can be put most pointedly by way of an example. Jenkins (1980) concludes that for 1979 alone, the loss to the economy per job saved by the protection through tariffs and quotas of the Canadian textile and clothing industries was \$34,500. As Watson (1983, p. 85) points out, since the average income of Canadian textile workers in the same year was \$10,000, all those who would have lost their jobs if protection had been removed could have been paid two or even three times their real 1979 incomes for the rest of their lives, and there would still have been something left over for consumers. What factors in our processes of collective choice prevent such social contracts from being struck?

In most cases, compensation on the scale instanced by Watson is, in fact, likely to exceed greatly actual income losses suffered. A study by Jenkins et al. (1978) of the experience of workers laid off from plants which closed, one in Sherbrooke, Quebec, and the other in Owen Sound, Ontario, found that the present value of per capita income losses over a three-year period varied between \$1,315 and \$2,983 (1971 Canadian dollars), using one data set and from \$1,294 to \$4,895 using a second data set. The income losses were found to be quite sensitive to the displaced worker's age and the general unemployment rate. A study by Glenday and Jenkins (1981) of the re-employment experience of 4,250 workers permanently laid off from the clothing, textile and knitting, and electrical products industries found significantly higher adjustment costs. The mean duration of the first unemployment spell after layoff was 12.5 months; subsequent unemployment spells had a mean duration of 16.1 months.

In short, while adjustment costs can be significant for workers affected, almost all studies show that the costs of trade protection (or gain from trade liberalization) far outweigh these costs. With respect to the potential gains for Canada from complete multilateral free trade (MFT), recent findings by Harris (1984) are striking: the gain to free trade in terms of Canadian real income from the initial 1976 levels of protection would be of the order of 8 to 10 percent of GNP. The Canadian real wage would rise in the order of 20 to 25 percent, with gains in labour productivity of similar magnitudes. The pattern of adjustment to MFT would primarily reflect intra-industry rationalization with improved cost efficiency in most manufacturing industries, achieved through realization of the advantages of larger scale. Under MFT, only the most labour-intensive sunset industries would lose. On an aggregate basis, approximately 6 percent of the labour force would be required to shift intersectorally. Under MFT, employment would actually increase in the manufacturing sector, and the sector as a whole would move into a trade-

surplus position. The industrial base of the economy would expand significantly under free trade.

Of course, changes in trade policy or, for that matter, in international competition are not the only source of adjustment in the domestic economy. Changes in such areas as technology, productivity, domestic demand, resource discoveries and depletions all can induce reallocation of economic resources. Indeed, Krueger (1978) found in a U.S. study that for the period 1970–76, demand change dominated imports as a source of employment change in 17 of the 19 two-digit Standard Industry Classification (SIC) categories. It may be that in a more open economy such as Canada's, changes in the international terms of trade are more significant sources of employment change than in the larger and more self-contained U.S. economy. The scale of market-adjustment processes at work from all these sources is indicated by data, cited by Green (1984), that of the firms and plants that accounted for almost all Canada's employment in, and output from, manufacturing and mining in 1970, about a quarter had disappeared by 1976; an approximately equal number were born during the same period.

In the light of these background data, it is now appropriate to turn to an examination of economic, equity (ethical), and political arguments for government intervention in the adjustment process. Here it must be emphasized that the first two perspectives are normative or prescriptive, while the third perspective purports to be exclusively positive or descriptive. In this respect, the first two perspectives can both be viewed as ethical in content, although for clarity of exposition the neo-classical welfare-economics theories that inform the first have been distinguished from particular philosophically oriented, utilitarian and social contract theories that inform the second. In undertaking this exercise, I seek to show that each of the three perspectives yields different policy implications with respect to the transition costs of industrial decline and, in particular, that the policy outcomes yielded by politically rational responses to the incentive structure imbedded in our political institutions will often, for better or worse, be starkly at variance with those suggested by the two normative perspectives. If the net gains from trade liberalization are even remotely of the order of magnitude suggested in most economic studies, what inhibits our political processes from facilitating their realization?

The Economic Case

In a trade policy context, Pearson and Salembier (1983, p. 16) frame the efficiency issues as follows:

First, do the benefits from trade, properly discounted, outweigh the temporary adjustment costs? That is, are the costs to society of maintaining these

resources in their initial production greater or less than the benefits of maintaining their output? Secondly, are there government measures that would reduce the period of unemployment and hence minimize adjustment costs?

The authors sharply distinguish, from an economic perspective, social and private costs of adjustment. Social costs of adjustment would primarily involve forgone output from workers during periods of unemployment, following termination, in their next-best employment opportunities. Private costs would include the write-down in the value of physical assets of firms which can no longer compete in their initial markets, reductions in wages of workers as between their initial employment and their next-best opportunities (viewed as the loss of rents associated with job-specific human capital), and loss in value of employee housing following plant closure.

In a welfare-economics framework, it is not clear that this distinction between social and private costs is valid. In this framework, the question is whether a change in government policy, such as trade liberalization, is likely to produce a net increase in social welfare or utility. Under the Pareto principle, one can only be confident that there is a net increase in social welfare if the change in question makes some people better off without making any one else worse off. Because the utility functions of individuals are viewed as subjective, only voluntary transactions in which gainers compensate losers so as to secure unanimous consent to the change satisfy this criterion. Apart from providing a strong inference of an actual increase in social welfare, the Pareto principle finds independent normative justification in the weight accorded to individual autonomy and the right of individuals to avoid being used as instruments for the furtherance of other people's welfare without the cost bearers' consent. While the Pareto principle is sometimes advanced as a relatively uncontroversial normative principle that simultaneously satisfies utilitarians, Kantian social contractarians and wealth maximizers,³ its limitation is that only preferences supported by dollars are registered in the voluntary transactions it contemplates, despite the fact that increases or decreases in individual utilities may occur that will not be reflected in these transactions. Thus the existing distribution of wealth is taken as given, and involuntary redistributions of it are proscribed by the Pareto rule.

In any event, given the difficulty of negotiating the elaborate social contracts contemplated by the Pareto principle — which explains why the matter must be dealt with by collective majoritarian decision — the government's next-best option, in a welfare-economics framework, would be to undertake some form of cost-benefit exercise which assigned quantifiable weights to individual losses and gains from the change in policy and, if benefits exceed costs, to view the change as a *potential* Pareto improvement. Actual payment of compensation by the

gainers to the losers is not entailed. The gains are viewed as sufficiently substantial that hypothetically, compensation could be paid and leave a net gain from the change (Kaldor-Hicks compensation). The weights assigned in this exercise, however, are necessarily arbitrary, given the absence of revealed preferences through voluntary transactions, and thus they do not permit of interpersonal utility comparisons. Because Kaldor-Hicks is silent on an appropriate distributional principle to govern the distribution of the gains from change, that principle has no implications for whether one form of distribution increases social welfare more than another; this question cannot be answered within a welfare-economics framework and entails adoption of some ethical theory of distributive justice. Moreover, Kaldor-Hicks is vulnerable to the criticism that because compensation is not, in fact, paid to the losers (as it is in actual Paretianism), the losers are used as involuntary instruments for the realization of welfare increases by others. Thus, Kaldor-Hicks compensation is a straightforward form of consequentialist utilitarianism in which reductions in utility to some are viewed as justified by greater increases in utility to others, no matter how distributed or how determined.⁴

One feature that both the Pareto principle and Kaldor-Hicks compensation appear to share is that they involve no distinction in the treatment of social and private costs. A somewhat different approach, adopting a market-failure framework, renders the distinction more tenable. Here, the assumption is that in general, voluntary market exchanges will ensure that economic output from a given set of inputs will be maximized, and hence that social welfare will be maximized. This will be so, even though the outcome of these market processes will not, in fact, be that some individuals will be better off while no one will be worse off (the Pareto welfare test). Not all buggy-whip makers and blacksmiths were demonstrably better off as a result of the advent of the automobile. Although some may have found more productive and remunerative opportunities in the new industry, others were presumably remitted to less attractive alternative activities than their previous occupations. It is *assumed* here, however, that the market outcome is such that the gainers could have compensated the losers and still have been better off than before the technological change. The losses sustained by the losers, who have been “competed out of business” by the technologically more advanced producers of substitutes, are viewed as a pecuniary (as contrasted with a technological) externality having mainly distributive, but not allocative, effects. These assumptions about the connections between market transactions and social welfare are conventionally viewed as holding in the absence of market failures such as monopoly, public goods and externalities.

By a similar line of reasoning, in response to Pearson and Salembier’s first question about a change in trade policy — Do the benefits from

trade outweigh the adjustment costs? — the neo-classical economic response would be that if the change involves trade liberalization and according an enhanced primacy to undistorted market transactions, one can *assume* that gains outweigh losses: that consumers have demonstrated with their dollar votes that they do not consider the domestic output lost as a result of trade liberalization as worth the cost of maintaining that output. Displaced workers and owners of physical capital are viewed like the blacksmiths and buggy-whip makers of yesteryear, who were required to suffer private losses in the service of a greater social good: larger or more highly valued economic output. It is assumed that the losers suffer only transitory losses, and that they are reabsorbed into the economy more or less immediately in more productive and better remunerated roles, or at least that this will be true of succeeding generations. In this sense, market-adjustment processes are assumed to make everybody better off in the long run.

This leaves us at a point where the conventional economic case for intervention in market-adjustment processes, however precipitated — changes in trade policy, international competitiveness, technology, demand — is a very limited one and is dependent on demonstrating some defined form of market failure. This conclusion is particularly directed to declining sectors which have lost their long-run comparative advantage (or never possessed such an advantage, but have been sustained by protection or subsidy). Somewhat different considerations apply to the role of macroeconomic and exchange-rate policies in influencing the general pattern of economic development and to policies directed to growth sectors, such as support for infra-structure and research and development (R&D) and to public support of education and basic research.

With respect to declining firms or sectors, can potential market failures be identified which provide efficiency rationales for government intervention in the adjustment process? With respect to capital, the case generally seems unconvincing. Write-offs of the value of physical capital as a result of changes in competitive conditions are purely private losses, not social costs. Society now revalues these assets at whatever they may be worth in their next most highly valued use. There is no efficiency rationale for preventing these losses or compensating for their occurrence. For the most part, government can best facilitate the reallocation of physical capital by removing legal impediments to its mobility. For example, unduly restrictive anti-trust policies toward firm mergers, restrictions on foreign take-overs or mergers, provincial securities law that imposes costly conditions on take-over bids through “follow-up offer” requirements, and corporate-law rules that permit incumbent directors to take defensive measures in the face of a take-over bid may mute market processes that induce private rationalizations and restructurings. Tax policies that constrain the ability of acquiring companies to

claim accumulated losses incurred by firms taken over may be another example. Efficiency-based modifications to these policies would all be directed to speeding up market-adjustment processes as they bear on the reallocation of physical capital, rather than retarding them.

On the other hand, it has been argued that market forces will sometimes lead to premature termination of firms in financial difficulties, resulting in inefficient reallocation of resources. It is argued, for example, that our present bankruptcy laws may create incentives for well-secured creditors to “pull the plug” on firms with a potential for restructuring into new product lines, rationalizing or down-sizing productive capacity over time, or modernizing production processes. Transaction cost and strategic behaviour considerations may inhibit the major stakeholders (various classes of shareholders, various classes of creditors, employees) from negotiating a post-insolvency bargain that will maximize the value of the company’s assets. How serious a problem premature (economically inefficient) bankruptcy is empirically is difficult to judge. Bankruptcy data in Canada disclose very few large firm bankruptcies; the costs, delays, and inefficiencies of the bankruptcy process itself create significant countervailing incentives for the major stakeholders to avoid bankruptcy in many circumstances, even perhaps in cases where, absent these costs, bankruptcy and subsequent redeployment of assets would be an efficient outcome. In this context, proposals for the adoption of bankruptcy policies modelled on Chapter XI of the *United States Bankruptcy Act*, which would constrain the ability of secured creditors to enforce their security against firms undergoing court-supervised reorganizations and authorize the court to impose (“cram-down”) reorganizations on shareholders and creditors, may have economic merit; so, too, may suggestions for modifying voting rules with respect to voluntary proposals to reduce hold-out and strategic behaviour problems and thus facilitate voluntary reorganizations.⁵

Another argument that market forces may lead to the inefficient termination of failing firms revolves around claimed capital-market imperfections. The Economic Council of Canada (1982) in a recent study of programs of government financial assistance to industry argues the possible existence of a “credit gap” that results in firms which present objectively equal risks to investors being differentially treated by the capital market. The Council points to disproportionately high transaction costs facing small businesses in obtaining loans, and disproportionately high costs and legal difficulties in small firms raising equity through small public offerings, that may result in a bias toward excessively highly-leveraged capital structures in the classes of firms affected by these costs. This finding may then support a conclusion that government financial assistance to such firms may be warranted, either on start-up or when financial difficulties are encountered.

In general these arguments are not convincing. Other researchers

have not found that small businesses encounter special difficulties in raising debt or equity capital. Even if this were so, it then would have to be demonstrated that government intervention in subsidizing the availability of financing could reduce the costs that private sector financial institutions face in servicing small businesses. If real social costs are involved, what comparative advantage does government possess in reducing these costs of providing capital? Finally, even if the argument and its policy implications are cogent, only small businesses seem to fall within its scope, not larger failing firms or declining sectors generally.⁶

A further argument for intervention revolves around lumpiness in the downside adjustment process. Harris (1985, chap. 7) argues that firms are able to undertake an efficient adjustment to a decline in demand in competitive industries with no scale economies whatever. Here, the decline in industrial capacity is carried out by each firm gradually lowering its own capacity and hence employment. But if there is some degree of indivisibility in plant or firm size so that efficient industry adjustment to a decline in demand requires that firms exit in some orderly temporal sequence, market forces may not produce this sequence. A case may thus arise, so it is argued, for a government role in managing adjustment to the contraction in demand, perhaps through "recession cartels," active promotion of mergers, compensation for scrapping physical capacity. This argument is difficult to evaluate: if sound, it should apply equally to expansion in imperfectly competitive industries with scale economies as well as to contraction, and it quickly then generalizes to a case for pervasive government intervention in most industrial sectors. Moreover, it assumes that government can economize on transaction costs in this context in ways not open to private firms through mergers, specialization agreements and other means. As applied to well-functioning capital markets, this assumption seems dubious. Conversely to Harris' view, it may be argued plausibly that the contraction problem, even in imperfectly competitive markets with scale economies, entails fewer inefficiencies than the expansion problem. With expansion, there may be surplus-dissipating races to pre-empt additions to the market. With contraction, each producer drops out as its quasi-rents fall to zero. There is no racing or gaming problem, and no firm can credibly threaten to add new capacity. Exit is likely to occur in reverse order of age of facilities.

A final argument that sometimes is made for intervention at the firm or industry level in declining sectors relates to "unfair competition." Here it is argued that foreign firms often unfairly compete with import-sensitive domestic firms or sectors as a result of predatory behaviour or home-country subsidies to production or export. This action obscures underlying comparative advantage or relative competitiveness and leads to decline in affected domestic sectors that in no way reflects on the efficiency of these sectors. This argument typically leads to a case for

countervail measures, anti-dumping legislation or offsetting domestic subsidies.⁷

First, it is not at all clear that foreign firms, in the absence of subsidies, have any incentive to export goods below cost. It would be more economically rational not to produce goods at all in these circumstances. It is sometimes argued that foreign firms may do this to maintain lumpy capacity and a market presence or profile pending an up-swing in demand for their products. In general, producing at a loss seems a costly and inefficient way of achieving these objectives. Alternatively, it may be argued that selling below cost may be part of a strategy of predation, designed to eliminate domestic competitors and then raise prices to monopoly levels. The anti-trust literature on predatory pricing is extremely complex and controversial, but two points seem to constitute common ground: first, that predatory behaviour — selling below some measure (which is vigorously debated) of cost — is rarely economically rational; secondly, that distinguishing inefficient forms of predation from efficient forms of vigorous price competition is extremely difficult.⁸

Where firms are selling below cost as a result of home-country subsidies, it is not clear why equalizing or neutralizing the subsidy through tariffs or subsidies designed to benefit domestic firms has any economic justification. Now taxpayers (or consumers) in two countries underwrite a zero-sum or negative sum game. It would seem to make more economic sense for domestic consumers to enjoy the benefits of the foreign subsidies, treat them as a gift, and support the reallocation to other uses of domestic resources in the affected sectors.⁹ Moreover, as Krugman (1984, pp. 15–17) points out, “in practice, an industrial policy aimed at meeting foreign [subsidized] competition would probably lead to government encouragement of investment precisely where the returns to investment are depressed by the targeting of other governments.” Krugman cites steel as an example. Another example is shipbuilding. Thus, on the firm or capital side, the economic case for government intervention to retard the process of decline or to underwrite its costs is, in general, not very convincing.

With respect to the adjustment costs faced by labour in declining sectors, the economic case for intervention is somewhat stronger. While the decline in income suffered by redundant workers is viewed economically as a private cost analogous to the write-down in value of physical capital, the loss of output sustained by the economy while the workers are unemployed is a social cost, measured in terms of what that output would be in the next-best employment opportunity. This goes principally to the second question posed by Pearson and Salembier (1983, p. 16): “Are there government measures [available] that would reduce the period of unemployment and hence minimize [social] adjustment costs [to optimal levels]?” The first question the authors raise is also implicated to the extent that in an extreme recessionary environment with

very high levels of unemployment, a case can be made that in declining sectors with rigid wages and highly immobile labour, a temporary output subsidy may be cheaper than extended unemployment benefits, forgone tax revenues, additional demands on social services, and other costs. In other words, as a social welfare policy (not an economic policy), it may be cheaper to provide social assistance through temporary output subsidies to the firm rather than through the social welfare system.¹⁰ Such an argument, however, needs to be treated with extreme caution because the action it proposes clearly retards adjustment, at least in the short run, does nothing to facilitate the redeployment of redundant labour in the long run, and to a large extent perpetuates and reinforces the conditions which may make such a policy an optimal social welfare response in the first place. Moreover, the substantial gains to free trade relative to income losses that it may cause, as reflected in data cited earlier, suggest that it will be very rarely indeed that these conditions are satisfied.

A similar argument that is sometimes made for temporary firm subsidies is that in generally or regionally depressed labour markets with very high levels of unemployment, mass layoffs create congestion externalities akin to decisions to enter an already over-crowded highway or to move to an already over-crowded city. Each worker's search efforts increase the search costs of other workers, but these costs are external to the relationships between workers and employers in firms or industries facing contractions and layoffs. On the other hand, search efforts of workers in aggregate may create offsetting positive externalities for potential employers by reducing their recruitment costs and for workers themselves in the form of information about market conditions obtained by some workers but of use to others. In the case of mass layoffs, however, it may well be that the negative externalities outweigh the positive. Potential policy responses might entail either taxing the source of these externalities or subsidizing the source not to produce them. The source in this context could be viewed in theory as either employer or employee in firms where mass layoffs occur, but distributionally and operationally it might be more tenable to view the employer as the source. This would suggest "taxing" the employer for mass layoffs, through such means as minimum notice periods and/or substantial severance payments or subsidizing him/her to maintain employment until the congestion in the labour market is reduced, presumably by an up-turn in the business cycle. Both policies present difficulties. Employers might view a tax on firings as constituting also an indirect tax on hirings, which might exacerbate unemployment conditions. A subsidy to maintain employment postpones the realization of the efficiency gains from real-locating the physical assets of the firm to more productive uses and does nothing to ensure that workers acquire skills that make them more employable in other occupations or sectors. Moreover, it is possible that

the availability of subsidies to industries with *potential* layoff congestion problems will encourage more firms and workers to enter such industries, thus largely undermining the effects of a subsidy designed to offset the congestion. In an analysis of 14 recent corporate bail-outs by governments in Canada, the authors concluded that only Chrysler, Massey-Ferguson, White Farm, and perhaps the Atlantic fish-processing companies plausibly fell within the range of this argument. Moreover, at most, the argument implies a case for *temporary* protection or subsidy in severe recessions.¹¹

A more general and probably more potent argument for government intervention with respect to labour-adjustment costs in declining sectors presents a case for subsidizing the costs of retraining. Essentially, the argument points to imperfections in the market for human capital.¹² Particularly in the case of general (as opposed to specific) human capital that can be used in several occupations or industries, employers may underinvest in worker training because the benefits of that training can be appropriated readily by other employers without compensation. Workers themselves may be unable to finance the costs of general training by such means as wage reductions during the training period, or to meet the opportunity and direct costs of institutional training, in part because of inability to borrow against expected future income streams, which can only effectively be pledged as collateral by pledging their own future services. This arrangement might be viewed as a contingent form of indentured servitude and would not be legally enforceable. Thus a case emerges for subsidizing, at least in part, the opportunity and direct costs of general training or retraining, although the argument does not discriminate between the two, and does not in itself support a case for special retraining subsidies for workers laid off in declining sectors. Rather it supports a case for subsidizing the availability of general institutional and on-the-job training and retraining programs for unemployed workers, whatever the source of the unemployment. In addition, even in relation to some specific forms of human capital where economies of scale or specialization in its formation make institutional training more efficient than on-the-job training by employers, efficiency objectives might be served by providing loans (although not necessarily direct subsidies) to trainees to finance the costs of training or retraining. Moreover, it might be argued that in the case of highly specialized investments in human capital, the worker assumes a high degree of undiversified risk relating to the continued value of his investment and, if risk averse, would wish to be insured against substantial depreciation of his or her capital as a result of exogenous changes in his/her economic environment. If private insurance markets are incomplete and are unlikely to provide such insurance, a case might be made for some form of social insurance (as argued more fully below).

A related argument that supports these policy implications is that

workers who have suffered layoffs, but are in receipt of unemployment-insurance benefits do not face the full social costs of their unemployment and thus may withhold their output from the market for inefficiently long periods of time. One response to this argument would be to abolish unemployment insurance. Apart from distributional objections to this response, however, it might prove economically counter-productive in many instances because one of the rationales for unemployment insurance is that it improves the quality of job search and resulting employment matches by providing time for more extended search. Nevertheless, the argument has force to the extent that studies have found that the availability of unemployment insurance appears to increase the unemployment rate by 1 to 2 percent.¹³ A different response to these efficiency losses arising from unemployment insurance might be to modify the latter, perhaps by arrangements to experience-rate firms or for industries to force up worker contributions to unemployment-insurance programs in industries with high layoff records or even unemployment patterns of a cyclical nature; abandoning special regional benefits to workers which encourage the unemployed to remain in areas with low employment prospects; conditioning benefits, after a limited period of time, on undertaking institutional or on-the-job training.¹⁴

To summarize the thrust of economic rationales for intervention in declining sectors to mitigate adjustment costs, arguments for subsidizing firms seem generally unconvincing, with the possible exception of the congestion-externalities argument for mitigating labour-adjustment costs through temporary subsidies to firms for job maintenance in highly depressed labour markets. Apart from the latter, arguments for direct subsidies of labour-adjustment costs seem most compelling with respect to imperfections in the market for human capital and make a case for subsidizing the cost of general training and retraining. It should be emphasized that very few of the rationales for government intervention to mitigate adjustment costs in declining sectors are specific to any particular source of decline, such as changes in trade policy or international competition, and therefore do not imply policies that are so constrained. Essentially, if economics dominated the policy-making process, these are the only policies we would observe in place that bear on adjustment costs in declining sectors. Clearly, there are more forces at play in the policy-making process than economics.

The Ethical Case

Ethical theories that might be relevant to the case for government intervention to moderate or underwrite the costs of adjustment in declining sectors are more complex, diverse and indeterminate than the neo-classical economic paradigm. Yet they are important in the present context to the extent that they embody widely held moral intuitions

about just treatment of losers from change, and in this respect they may be part of a society's value framework or ideology.

Two alternative ethical frameworks that have long enjoyed wide currency in philosophical debates are reviewed by Quinn and Trebilcock (1982, p. 117) in a context similar to the one under consideration in the present study. Without repeating the analysis in detail here, the approaches of Utilitarianism and Kantianism (social contract theory) are compared in the way that claims for compensation for losses from regulatory change, such as deregulation, might be evaluated ethically.

In a world of perfect information and costless bargaining, the Paretian social welfare test would always insist on negotiated compensation for the losers from any public program designed to advance economic efficiency. Yet information and bargaining are costly, and almost by hypothesis, the reason why the issue has been remitted to the public domain is that voluntary, mutually advantageous, private agreements cannot be realized, given these constraints. A straightforward utilitarianism (as embodied in the Kalder-Hicks hypothetical compensation principle) would not compensate losers through public compensation payments, provided that the "felicific calculus" is satisfied. The authors argue, however, following Michelman (1967, p. 1165) that given an assumption of some degree of risk aversion on the part of most members of the community, utilitarian policy makers may wish to control uncertainty costs through compensation for change and, also, disaffection costs to the extent that individuals entertain a special sense of grievance at being singled out by the collectivity to bear uncompensated losses. (Uncertainty costs and disaffection costs are together characterized as demoralization costs.)

The analysis, then, suggests that a utilitarian compensation practice is likely to be concerned especially with policy changes that frustrate long-standing, institutionally grounded expectations. Whether reliance on the status quo is reasonable or not is likely to depend in large part on whether changes in the policy environment could reasonably be anticipated, and whether the risks of these changes were subject to *ex ante* compensation through market transactions that discounted for these risks or diversified them away. Some risks also may be subject to an implicit *ex post* compensation dynamic to the extent that "log-rolling" in the political process may have a tendency to even out over the long run the distribution of at least small-scale gains and losses from collective decision making. This analysis suggests that large, unanticipated, individual losses from policy changes are likely to generate the greatest demoralization costs. In the context of this study, this might suggest that employees often will be able to make out a stronger case for liberal compensation policies than will investors, in large part because it is often more difficult to diversify investments in human capital than to do so in other forms of capital where firms can diversify their activities and shareholders can diversify their portfolios.

This view, of course, is consistent to this point with the earlier economic analysis. However, important differences remain. A utilitarian framework would require that employees subject to these demoralization costs, once incurred, presumably should be compensated for their *private* losses, which are part of the source of these demoralization costs; they should not simply be the focus of policies that attempt to offset *social* costs from unemployment. As Green (1984, p. 19) has argued persuasively, these private costs may be substantial, and indeed their size may swamp the social costs, such as losses relating to employer pension-plan contributions, seniority rights or tenure, resale value of owned home, local amenities or environment, and language. Moreover, second-order losses to remaining numbers of communities faced with industrial decline may be substantial, with contractions in the tax base but high fixed costs in the provision of public services.

In the utilitarian framework developed by Quinn and Trebilcock, settlement costs in tracing and measuring losses to be compensated enter the utilitarian calculus, especially with respect to the choice of compensatory instrument. Both lump-sum compensation at the time of the policy change and compensation for actual losses incurred thereafter often will involve extremely high settlement costs. (These often include severe moral hazard problems in incurring or inflating losses.) A third option involves some temporary delay of, or even permanent exemption from, the policy change which, while achieving strong vertical equity, has weak horizontal equity properties in targeting actual losses accurately within the affected class, as well as deferring, and thus reducing, the social gains from the change. A fourth option is some form of subsidy not directly linked to the actual losses of specific losers. This might take the form, among others, of wage subsidies, income-maintenance programs or retraining subsidies. This strategy, while reducing settlement costs and preserving the efficiency gains from change, also has poor horizontal equity properties, which is likely to mean that demoralization costs still will be substantial and if large enough may tip the utilitarian calculus in favour of the third option.

Two residual issues require mention. While the application of a particular form of the utilitarian ethical framework to such matters as changes in trade or subsidy policy applicable to a declining industry has been traced out, in theory the compensatory implications of the framework are potentially relevant to changes in any government policy where the losses from the changes satisfy the criteria reviewed. This again, as with the economic framework, suggests some difficulty in justifying special compensatory arrangements for changes in trade policy. It may also raise some disturbing implications for the ability of the government to promote major redistributive policies which, by definition, are self-cancelling if the losers must be compensated. Thus, prevailing patterns of wealth distribution, whether ethically defensible or not, are permanently sanctified.

An equally troublesome issue is whether the utilitarian framework applies only to formal state action, rather than to inaction. For example, if government observes an industrial sector undergoing dramatic decline, with associated mass labour layoffs, as a result of increased international competition, and elects to acquiesce in the process of decline (which may be efficient), are the resulting losses subject to the same utilitarian compensatory calculus as losses induced, for example, by a change in tariff policy? Michelman (1967, pp. 1214–16) has argued that disaffection costs induced by direct state action, where this may be perceived by the losers to be a result of majoritarian tyranny, are likely to be systematically higher than the same costs in losses not directly attributable to state action. This view seems to carry limited force, given evolving societal expectations of the state over recent decades, when intervention by government to redress significant social grievances has come to be increasingly assumed. Moreover the distinction between state action and inaction is largely illusory, because even in cases of “inaction,” economic outcomes will be determined by ground rules laid down by the state. (These include the definition, enforcement and transferability of property rights.)

Finally, as in the above example, the issue of defining and justifying the boundaries of community over which the welfare-maximizing calculus is to be applied is problematic for utilitarians. If a source of increased international competition is low-wage, impoverished, Third World countries, should their welfare enter the utilitarian calculus?¹⁵

In short, utilitarianism does not offer precise normative implications for the role of government in addressing adjustment costs in declining sectors. It does, however, suggest that large, unanticipated, private losses (principally those incurred by labour), should probably, whatever the source, be subject to a compensation principle, although settlement costs involved in calculating explicit compensation sometimes may be an argument for deferring or attenuating the process of change.

A Kantian (or social contract) ethical framework emphasizes respect for human autonomy and tends to be critical of utilitarianism for failing to respect individuality because, in one version of the felicific calculus (subject to the problem of measuring losses and gains in utility), it may justify harming one person if others benefit more than that individual suffers. The Rawlsian version of this approach constructs a hypothetical social contract by hypothesizing individual preferences behind a veil of ignorance where individual endowments and utility functions are not known. In this scenario, each individual must consider the possibility that she or he will become the worst-off individual in the community. All members of this social contract will agree to inequalities only if they would advance the position of the least well-off members of the community. This situation can be viewed as an agreed form of social insurance.

This framework, which assumes extreme risk aversion on the part of

all members of the social contract — and has been criticized on that account — would seem to imply a compensation principle directed specifically at the least-advantaged victims of change. As with utilitarianism, private losses would be compensated, although Rawls does not appear to be opposed to employing the most efficient form of compensation (which seems also to render settlement costs a relevant consideration). The social contract framework differs from utilitarianism, however, in that claimants of compensation would, in effect, be subject to means testing and presumably would constitute a smaller potential class of compensation recipients (probably some subset of redundant labour) than would those suggested by utilitarian considerations. Moreover, nothing in the Rawlsian analysis would limit his distributive principles to direct state action. The ground rules of the society and the economy generally must presumably comply with his principles if these rules (including those structuring a market economy) affect distributive outcomes. Thus, the source of losses in declining sectors or elsewhere is irrelevant; only the characteristics of the loss bearers are important. This framework strongly points in the direction of general welfare or redistributive policies that correct for inequalities, however generated, rather than specific policies focussed only on declining sectors or subsets of these sectors in cases of decline resulting from explicit changes in trade policy. However, it might be argued persuasively, within a Rawlsian framework, that in import-impacted sectors facing increased competition from low-wage, newly industrializing countries (NICs) or less-developed countries (LDCs), a particularly compelling case exists for assisting displaced workers, who are typically among the least-skilled and lower-paid members of the domestic labour force; they should not be required to bear the brunt of the adjustment costs entailed in realizing the welfare gains from free trade or in honouring redistributive ethical obligations that developed countries might be perceived as owing to Third World countries by providing them with access to our markets.

Finally, it should be noted that while there are differences among various versions of the ethical and economic frameworks, there are also some striking similarities. In particular, both frameworks would focus attention on workers rather than investors in justifying special assistance in the face of economic disruptions. Moreover, the reason for this is, in many respects, common to the two frameworks. If one assumes risk aversion on the part of workers and limited ability to diversify away the risk of future redundancy as a result of exogenous events, a case for providing insurance arises. Economists might be inclined to ask why private insurance markets would not provide such insurance if it were demanded, but would probably accept that problems of adverse selection, moral hazard and perhaps non-diversifiability (in the case of large exogenous shocks) might make such insurance

unavailable or at least extremely costly. This might perhaps be viewed as a form of market failure, raising at least a question of whether social insurance should be provided or underwritten by the state, although a neo-classical economist might remain sceptical that the state can overcome these private market failures at any lower cost than can the market itself.¹⁶ In this event, social insurance is likely to replicate some of the imperfections in private insurance markets, such as adverse selection and moral hazard, and to allocate the costs of these imperfections in inefficient and perhaps ethically perverse ways. The point remains, however, that market-failure arguments in an economic framework and utilitarian and Kantian ethical arguments for compensation converge to a significant extent and yield a sharp focus on the adjustment costs faced by labour rather than by capital.

The Political Case

Reasons for Intervention

The political framework, in sharp contrast to the economic and ethical frameworks, is positive rather than normative in nature. In particular, the public choice (or economics of politics) framework assumes as its basic behavioural postulate in collective decision making the same postulate as it assumes in private market interactions, namely self-interested utility maximization on the part of all affected individuals. It then attempts to describe incentive structures that operate on political actors (voters, interest groups, politicians, bureaucrats, the media) as a result of the constitutional and institutional arrangements within which they operate, and — perhaps more speculatively — predict policy outcomes in particular policy contexts, given these incentive structures.

Within this general framework, the following more specific axioms are advanced as attempting to describe rational political behaviour within these structures (Trebilcock et al., 1982, chap. 3):

- (1) It is in the interest of a governing party to choose policies that confine the benefits to marginal voters and confine the costs to infra-marginal voters (marginal voters being defined essentially as swing voters in swing ridings).
- (2) In order to overcome the information costs faced by marginal voters, it is in the interest of a governing party to choose policies that provide benefits in concentrated form, so that their visibility is enhanced, and to impose the costs in dispersed form, so that their lack of visibility is enhanced.
- (3) A governing party cannot choose only policies that provide highly concentrated benefits because the more clearly visible benefits become, the smaller becomes the group of voters on which a party can realize a political return.

- (4) It will be rational for a governing party to treat highly concentrated or well-endowed interest groups as marginal voters to the extent that they possess an ability to provide, or threaten to provide, directly to marginal voters, subsidized selective information that might change their political preferences, or to provide resources to the governing party with which it can, in turn, either confer benefits on marginal voters or provide marginal voters with subsidized selective information intended to influence their political preferences.
- (5) In order to secure the cooperation of bureaucracies in implementing policies, a governing party is likely to attach special weight to the views of bureaucrats in formulating policies. Bureaucrats, in advocating policies to their political overseers, will have a tendency to favour policies that have a heavy bureaucratic orientation, entailing more jobs, larger fiefdoms, and more power and prestige. The virtues of non-collective, decentralized forms of resource allocation are likely to be depreciated.
- (6) Perceived benefits can be made to appear greater than real benefits through the provision by a governing party (typically through the mass media) of subsidized selective information, often of a highly symbolic nature.
- (7) Where, in order to confer benefits on a relatively dispersed group of marginal voters, it is necessary to impose costs on a relatively concentrated group of marginal voters, it will be in the interest of a governing party to choose a policy instrument that minimizes real costs over time, while obscuring the erosion of real benefits through the provision of symbolic reassurances to the beneficiaries of continuing commitment to the initial policy.
- (8) Where the dispersion of costs does not fully obscure their existence from the marginal voters who are bearing them, it will be in the interest of a governing party to provide subsidized selective information and symbolic reassurances to the cost bearers to reduce perceived costs below real costs. Costs will be represented, to the extent perceived, as "sacrifices" or "investments" made to secure long-term benefits.
- (9) It will be rational for a governing party to choose policy instruments that confer benefits, or perceived benefits, on marginal voters throughout, or at least late into, the current electoral time period, while attempting to defer the real and perceived costs borne by other marginal voters to some point in time beyond the current electoral time period, where causal connections are attenuated. Where this is not possible, instruments may be chosen that impose these costs at the beginning of the current electoral time period rather than at the end, so as to exploit incomplete voter recall. For similar reasons, a governing party will tend to offer policies at election time designed to maximize voter support, while between

elections policies may tend to be offered that maximize organized interest-group support.

- (10) Where a governing party is uncertain about the effects of alternative policy instruments on marginal-voter interests or on marginal-voter awareness of these effects, about the intensity of voter preferences surrounding these effects, or about opposition parties' alternative policy proposals on these issues and voter responses to them, it may be rational to choose an instrument that maximizes reversibility and flexibility so that continuous marginal adjustments in the balancing of interests can be made over time.
- (11) Where policies impose real and perceived costs on marginal voters, it may be rational for a governing party to assign the administration of the policies to an "independent" agency of government, so that the causal relationship between the costs and the party is attenuated in voter perceptions.
- (12) Widely dispersed interest groups and groups of voters who possess inferior information-processing capacities are particularly vulnerable to the substitution of symbolism for substance in the choice of policies.
- (13) Recognizing the limited investment in information about policy issues that most voters are willing and able to make, the media often will tend to trivialize complex policy questions, both in the identification of the issues and in the proposed prescriptions for their resolution. This often may involve the advocacy of simplistic, collective policy responses to perceived matters of public concern so that stories can be turned over at a rate sufficient to retain the public's attention. Because the public may be influenced by this advocacy, politicians may also be compelled to attach weight to it.

There seems little disagreement that political variables better explain existing patterns of trade protection than any economic rationales.¹⁷ While empirical studies of what political variables are most significant as explanators of protectionist outcomes reach somewhat diverse findings, market concentration on the firm side (implying more concentrated lobbying efforts and fewer free-rider problems) and large numbers of low-skilled, low-wage workers seem to emerge as important variables. Moreover, when the firms and work forces are geographically concentrated in particular regions or communities, the economic costs of decline become concentrated in ways to which the political system is particularly sensitive because of the manner in which it defines particular political constituencies. If affected regions or communities are concentrated in particular provinces, provincial governments are likely to become strenuous advocates of these constituencies' interests in federal-provincial relations, especially where the costs of protection can be largely externalized outside the province. The federal government

will be particularly sensitive to regional concerns where the continuing support of a region is crucial to its electoral survival. Given the regionally-differentiated support bases of the two major federal parties in Canada until recently, this has been a particularly crucial consideration. The federal Liberal party has depended principally for its political support on Quebec, Ontario and the Maritimes. Industries such as textiles, clothing, shoes, shipbuilding, automobile manufacturing and some forms of coal-mining are mostly concentrated in these areas, and the economic costs of decline in these economically vulnerable sectors are likely to translate into substantial political costs, in the absence of intervention. This is likely to remain true to a significant extent even in the current political environment, where the federal Progressive Conservative government now draws substantial political support from these regions. Western Canada, which historically has borne a disproportionate burden of the costs of Canadian protectionist policies, through being compelled to purchase from Central Canada manufactured goods produced behind tariff walls, and through being forced, more recently, to sell natural resources to Central Canada at less than world prices, lacks the population base of Central and Eastern Canada, especially Ontario and Quebec, and hence the political influence to countervail these policies. Regional divisions of economic activities and political influence thus make both federal and provincial governments particularly susceptible to claims for protection from some (most) of Canada's most economically troubled industrial sectors. That economic interests are defined so predominantly in regional terms is one of the most striking characteristics of economic policy making at both levels of government in Canada and exacerbates inter-regional "prisoner's dilemma" (or "beggar-thy-neighbour") tendencies in policy making.¹⁸

On the other hand, of course, many of the costs of protectionist policies are also experienced within the same political communities in which the benefits are derived. Where protected goods, such as textiles, are inputs into other industries' outputs, such as clothing, some of the costs of protection are borne by capital and labour in the latter industries. Even where the protected goods are final products, as with shoes, the majority of affected consumers are often concentrated in the same political constituencies as the factors of production (capital and labour) which stand to benefit from protection. Moreover, where protectionism carries a risk of retaliation from affected foreign countries, locally-based export industries are potentially prejudiced. Thus, regionalism, without further refinement, is an incomplete explanator of effective political demands for protectionism.

To locate the analysis within the framework of the earlier axioms, demands for protectionism would seem most politically salient where they are made by voters in ridings that are marginal in the sense that their allegiance to a particular party is contingent on the demands being met

or sustained. For these demands to be politically salient, a significant number of marginal voters in a marginal riding must feel relatively intensely in favour of them. This suggests that geographic concentrations of workers who stand to be prejudiced by mass layoffs probably constitute the critical political variable. The degree of unionization of the affected work force is also likely to influence significantly the ability of the workers to mobilize themselves and others for concerted political action. To the extent that workers, on relocation, face losses of specific human capital, resale value of homes in dependent communities, pension entitlements, seniority rights, cultural or linguistic networks or other fixities (that is, non-transferable, non-portable assets),¹⁹ their demands will be correspondingly more intense. They will be reinforced by the support of voters who may remain behind, but who will face higher infrastructure or public-service costs with a smaller tax base. They also will be supported by owners of physical or financial capital affected who, while less numerically significant as voters, may nevertheless possess financial and organizational advantages over other interests in influencing party policy. Thus, like the economic and ethical frameworks, the political framework suggests a primary policy focus on displaced labour, particularly in geographically and politically well-defined communities, if political opposition to the contraction of an industry is to be contained. In this sense, the source of political opposition can still be viewed as regional at a microcosmic level, where particular ridings define particular political constituencies. These considerations enable us to focus on the source of protectionist demands that politicians are likely to face and also to identify some factors that make it politically rational to respond to those demands.

To focus more fully on the supply side of the political equation, however, supplying these demands is unlikely to be without political costs. If protectionist policies in general reduce national income and, in particular cases, prejudice labour in industries for which the output of the protected sector is an input (and are thus rendered less competitive, with corresponding reductions in output and employment), why do workers not collectively agree to forswear protectionism? In large part, the answer is clearly that the gains and losses from either protectionism or liberalization are not evenly distributed. Thus, short of an arrangement that provides for a generally acceptable distribution of the gains from liberalization, some workers may well find it in their interests to oppose it. Moreover, without such an arrangement, there will be incentives for workers in all industries facing contractions in output and employment to demand protection or subsidy if the costs can be externalized to workers in other industries while resistance is maintained to demands for protection or subsidy from workers in other affected industries. This, again, from an interest-group perspective, is the classic prisoner's dilemma problem of negative-sum outcomes from non-coop-

erative behaviour. Frequently, in this process, demands will be met because the workers who stand to gain from protectionism or subsidy have much more concentrated stakes in the particular policy issue than have the workers who lose. Concentrated interests tend to prevail politically over dispersed interests, even though as a result in the present context, everybody may finally be worse off. The institutional fragmentation and absence of strong peak organizations in both the Canadian labour movement and Canadian business sectors may exacerbate these tendencies.²⁰ An attempt to divine the contours of an arrangement that mutes these incentives — a more advantageous social contract, in Rawlsian terms — is, of course, at the heart of this study.

Similar explanations apply in part to the question of why consumers, the chief beneficiaries of trade liberalization, are not routinely able to overwhelm labour's protectionist demands in the political arena. After all, consumers are vastly more numerous as voters than are workers or investors seeking protection or subsidy in contracting industries, and they appear to share strong common interests in resisting the costs associated with protectionism. Unfortunately, consumers as an interest group suffer from some severe political disabilities. First, unlike workers, their interest in the impact of particular protectionist policies is widely dispersed and thinly spread, and thus very few as individuals stand to gain or lose very much as a result of the choice of policy. As a result of their very limited individual stakes in the issue, consumers have highly constrained incentives to invest in the acquisition and evaluation of information about the issue (rational ignorance), and they face severe organizational disabilities in mobilizing themselves collectively as an interest group because of transaction-cost and free-rider problems entailed in such an exercise. Moreover, consumers are a peculiar form of interest group because almost all consumers are also producers (workers) and in the latter capacity may well find it in their interests to promote protectionist policies in particular contexts. (Most economics professors, for example, favour academic tenure in their own occupation, but free competition in most other markets.) This functional schizophrenia tends to complicate the consumer's political calculus.

Politicians, typically faced with political constituencies demanding protection or subsidy in geographically concentrated declining industries and widely dispersed or infra-marginal cost bearers (labour and capital in other industries, consumers, taxpayers, Western Canada), will engage in a political calculus that does not necessarily involve succumbing completely to the demands, but, rather, involves rational trade-offs in choosing policies that equate, at the margin, the political gains from the chosen policies with the political costs. The cost bearers are, of course, not totally without political influence, and moreover, the risk of international retaliation against protectionism implies potential negative domestic repercussions from affected export sectors. These political

costs are real; otherwise, in import-affected sectors, we should expect to observe tariffs set infinitely high or import quotas set at zero, which means that imports would be banned. In fact, we rarely observe the application of such policies. Indeed, the negotiation of the General Agreement on Tariffs and Trade (GATT) in the 1940s, and the Kennedy and Tokyo Rounds of multilateral trade negotiations in the 1960s and 1970s have resulted in substantial reductions in general levels of international protection. Lessons learned from the devastating tariff wars of the Great Depression (a classic case of the prisoner's dilemma phenomenon), post-war reconstruction strategies pursued by the Allied powers, widely shared perceptions that an important ingredient of more harmonious international relations was stronger trade links, and an expansionary economic environment at the time of the multilateral trade negotiations all provided an impetus toward liberalization. In growing economies, there appeared to be few losers from such a policy and, to the extent that there were any such, export-oriented industries often provided a strong countervailing, domestic, political constituency that stood to benefit from freer access to foreign markets, even though benefits were contingent on granting similar access to domestic markets for foreign exporters (Schwartz, 1982). These tariff reductions, however, have been very uneven across sectors, and domestic industries that are particularly vulnerable to import penetration have often continued to enjoy relatively high levels of protection. Moreover, with the onset, in recent years, of severe recessionary conditions throughout much of the world and with the growth of exports from Japan and low-wage newly industrialized countries (NICs) and less-developed countries (LDCs), often with deep impacts on particular domestic industries, a marked upsurge has occurred in the application of protectionist policies, especially non-tariff barriers. For example, Lawrence (1984, p. 120) estimates that the percentage of U.S.-manufactured goods protected by non-tariff barriers rose from 20 percent to 35 percent between 1980 and 1983. Such policies, not surprisingly, have particular application to economically troubled or declining sectors. Table 1-1 provides some indication of the current extent of these policies.²¹

All of these factors suggest that the political influence function with respect to trade protection is a complex one and will critically affect the choice of instrument when intervention of some kind in market-adjustment processes in declining sectors is deemed politically expedient. It is to the choice of instrument of intervention that we now turn.

The Choice of Instrument of Intervention

If job maintenance is the principal political consideration driving government intervention in the downside adjustment process, a major tension is quickly discernible between the economic and political

frameworks in the choice of instruments of intervention. The economic framework, it will be recalled, would tend to focus largely on policies that make labour more mobile, thus facilitating the adjustment process. For various reasons, the political framework will bias policies toward retarding the adjustment process.

Where industrial decline is a result of increased foreign competition, there will be strong incentives to use trade policy to retard the rate of change. Tariffs and quotas have several important and valuable political properties. Whatever the efficiency losses from protectionism, these losses will be to some extent externalized beyond the country, and to the extent that they are borne domestically, they will be thinly spread throughout the economy and largely invisible to the cost bearers, while the gains often will be highly concentrated and highly visible to the beneficiaries. Even in job-maintenance terms only, the jobs saved will be immediate, recognizable, highly visible and often highly concentrated, while jobs lost through misallocation of resources will be dispersed throughout the economy and over time, and will be largely invisible losses, even though in the long run the net impact of protectionism on employment in the economy is likely to be negative. In terms of magnifying the gain and depreciating the pain, tariffs are an ideal political strategy.

In this respect, the concept of "effective protection" is important. The level of tariff protection can also be disguised by manipulation of tariff rates so that commodities at a lower level of processing (steel, yarn) are charged lower duties than more finished items (automobiles, clothing). Caves and Jones (1985, pp. 233–35) give the following example of the concept of effective protection:

Suppose the free-trade price of clothing on world markets is \$1.00 and to produce a unit of clothing a country imports \$.40 worth of spun yarn from abroad. The domestic industry then creates an additional \$.60 worth of value added. Now, suppose a 40 percent nominal tariff is levied on clothing imports, raising their domestic price to \$1.40 and a 10 percent tariff is applied to imports of spun yarn, raising their cost to \$.44 per unit behind the tariff wall. The domestic producer now receives a value added per unit of clothing \$.96, the difference between \$1.40 and the \$.44 he spends as outlay on imported cloth. The difference represents an increase of 60 percent over the original value added $(1.40 - .44) / .60$. The tariff structure has yielded a 60 percent effective rate of protection to domestic clothing producers, whereas the nominal rate on clothing imports was only 40 percent.

It is generally agreed that effective levels of protection in Canada are higher than nominal levels, because of the low tariffs applying to raw material imports, although there are no recent studies of the level of effective protection which enable an assessment to be made as to how these levels have changed as the Tokyo Round tariff cuts have been implemented (Whalley, 1985).

TABLE 1-1 Import Restrictions on Key Industries in Selected Countries

[illegible]

It should be pointed out, however, that even in job-maintenance terms alone, tariffs are an imperfect instrument. By raising tariffs to reduce imports, domestic prices are increased so that domestic output and employment may not increase in proportion to the reduction in imports. Moreover, tariffs will not ensure the maintenance of jobs in the domestic industry if costs of foreign competitors continue to fall. This, of course, creates political incentives to invoke quotas which are more certain in their employment effects, although less certain than tariffs in the inefficiencies generated because changing cost differentials between foreign and domestic producers will not be readily discernible. Quotas, however, if not comprehensive, create incentives for countries bound by them to substitute other products, such as higher value-added products, for the product subject to quota, or for producers in other countries not bound by the quota to divert the export business to themselves. In either event, job-maintenance objectives in the affected domestic industry are unlikely to be fully realized.²² Moreover, quotas, unlike tariffs, enable foreign producers holding quotas to capture scarcity rents at the expense of domestic consumers.

While trade-protection policies generate significant efficiency losses and are an imperfect and costly instrument for realizing job-maintenance objectives, their political properties make them an extremely appealing instrument despite Henry Simon's (1948, p. 70) stern injunction:

Tariff legislation is politically the first step in the degeneration of popular government into the warfare of each group against all. Its significance for political morality is, moreover, quite potent. Against the tariff, all other forms of patronage and pork barrel legislation seem minor in importance.

It is important to compare the political properties of trade policies with those possessed by other available instruments that may be responsive to job-maintenance objectives. A focus on these alternative instruments is in part dictated by legal constraints on the deployment of tariff and quota policies to which Canada and most other major industrial nations are subject under GATT. These constraints, of course, do not affect the maintenance of tariffs agreed to in the last (Tokyo) round of multilateral trade negotiations, or agreed-upon "safeguard" procedures for industries seriously jeopardized by imports, or bilaterally negotiated "voluntary" export restraints. Thus tariff and quota instruments remain an important policy option.

Some of the alternative instruments involve non-tariff barriers to trade. These include government procurement policies, direct subsidies to domestic industry, and local content or sourcing requirements. While some of these are now constrained by the GATT's non-tariff barriers codes negotiated during the Tokyo Round, these codes are incomplete in their coverage, difficult to police, and difficult to enforce. Moreover, the alternative instruments are typically less attractive politically because

for the most part they entail direct and explicit expenditures by domestic governments. This is not the case with domestic content requirements, but the latter nevertheless require explicitly directed expenditures by domestic producers in excess of what competitive conditions would otherwise require; they may endanger the competitive position of industries subject to such requirements and hence, in turn, output and employment in those industries, a result which is obviously counter-productive in terms of job-maintenance objectives. Other available policy instruments that are responsive to job-maintenance concerns would focus directly on labour-adjustment costs by facilitating mobility to more productive occupations and otherwise compensating for losses associated with job termination.

In terms of choosing among these various instruments, political rationality would seem to imply the following ranking: a preference for off-budget instruments without clearly visible costs, such as domestic content regulations designed to benefit import-affected industries producing intermediate rather than final products; government procurement policy which, while involving on-budget expenditures, can operate in a low-visibility, unstructured, discretionary fashion with costs often difficult to isolate or quantify; direct subsidies to industry conditional on job maintenance and/or modernization while the subsidies themselves are largely concealed from cost bearers through tax expenditures, such as those for R&D and capital-cost allowances, loan guarantees or insurance, and loans at below-market interest rates (cash grants ranking last); finally, explicit cash subsidies to labour to mitigate adjustment costs.

As between adjustment assistance provided to firms and that provided to labour, the former provides a wider range of opportunities for concealing or depreciating the costs, as well as the potential for buying off both investors and workers simultaneously. The predilection for the use of loan guarantees in many recent government bail-outs of failing firms exemplifies this tendency, even though this has the undesirable consequence of encouraging over-leveraging in firms that are often already seriously over-leveraged. Assistance to firms also permits targeting on the marginal firms in an industry whose failure would have direct and immediate employment consequences, even though this assistance perpetuates both inefficient industry structures and conditions of excess capacity. Moreover, industrial assistance programs focussing on firms in declining sectors rather than on labour can be justified by symbolic reassurances to the public (taxpayers) in terms of "modernization" and "industrial renewal." A reference to the Canadian Industrial Renewal Board that provides assistance to the Canadian textile industry has a much more comforting ring to it than has a reference to Japan's Structurally Depressed Industries Law. The former can be projected as preserving and revitalizing a traditional industry; the latter explicitly acknowledges the loss of comparative advantage in designated sectors

and attempts to reduce physical capacity and facilitate the exit of labour from those industries.

In contrast to firm-oriented adjustment policies, labour-oriented adjustment policies cannot readily avoid major, explicit, public expenditures at a time when concern over public spending and the national deficit is acute; they acknowledge that an industry has no long-term future and that politicians have elected to acquiesce in its fate; they do nothing to ameliorate the losses of investors; and because large-scale public expenditures are involved if demoralization costs from industrial decline and mass layoffs are to be contained (which means that private costs, not merely social costs, must be compensated), politicians will feel constrained to ask whether expenditures on such a scale anywhere else across the political landscape will yield more positive political returns. Frequently, higher-profile spending programs with less ambiguously appreciative beneficiaries will be identifiable.

In summary, the political framework yields a set of positive policy implications that are in many respects diametrically opposed to those inherent in the economic framework and in many respects at variance with those inherent in the ethical framework. Confronted by sectoral industrial decline induced by changes in international terms of trade, politicians face incentives, first, to adopt tariff, quota or like policies where these are not legally constrained; where such policies are so constrained, politicians are impelled to adopt policies to subsidize industries at the firm level, to maintain industry output and employment by supporting the most marginal firms in the least visible or most symbolically reassuring ways; then to subsidize labour-adjustment costs, but tightly restrict the scale of direct expenditures in this context so as to contain public concerns over government spending and deficits, and to mute negative symbolism associated with acknowledgement of industry decline or death and the inability of government to avert that outcome.

Thus, our economic and political systems stand in sharp contrast in the way appropriate responses to industrial decline are conceived. The starkness of the contrast can, however, be overdrawn. As has been pointed out above, there are some political costs to protectionism, and politicians will trade off political costs and benefits. This will probably lead to the adoption of some mix of the above policies in declining sectors, but with the emphasis divided as implied by the above ordering. As Hillman has argued, drawing on the Stigler-Peltzman theory of regulation, it will rarely be in the political interests of politicians to resist decline completely, but rather to moderate its pace. Crude "capture" theories of government grossly oversimplify the complex political calculus that must be undertaken. Holding a tariff constant over time (or even providing for a gently phased reduction), while foreign competitors' costs continue to fall, supplemented with industrial assistance and

labour-adjustment policies, may be politically the optimal adjustment strategy.²³ Whether a better set of economic and political trade-offs can be realized will be addressed in the final chapter of this study after Canadian and comparative experience with adjustment policies in declining sectors is examined in intervening chapters.

Institutional Determinants of Adjustment Policies

In relating the analysis in this chapter to the comparative material in later chapters and then, in the final chapter, in seeking to identify possible implications for future Canadian adjustment policies, it is important to note an assumption that has so far underlain the present chapter. It has taken existing political institutions and organizations within the public and private sectors as *given* and attempted to discern the incentive structures within which these institutions and organizations operate in shaping policy. Comparative experience reveals, in some instances, sharply different institutional arrangements which appear to imply incentive structures that lead to rather different policy outcomes. This suggests a different order of political analysis: To what extent are these institutions a function of a different underlying history, culture, and ideology? To what extent have these institutions, in turn, shaped these factors? Which way does the causality run? Would these institutional arrangements, if transplanted to Canada, yield similar policy influences in this country? What would lead existing political institutions and configurations of political actors to accept alternative sets of political institutions and organizations? These are important and complex issues, and they extend to how and why a society chooses a particular political "constitution" for itself, and bear directly on how our economic and political systems are likely to interact with each other.²⁴

In a recent, provocative and controversial analysis of the institutional and political determinants of economic growth, Olson (1982) argues that long periods of political stability breed economic stagnation as narrow special-interest groups, over time, succeed in winning special favours from the state and gradually suffocate the dynamic impulses of an economy. Olson explains the success of the strong economies of the post-World War II period (especially those of Japan and West Germany) largely in terms of the disruption wrought by the war in established distributional coalitions. He argues that recent political instability followed by a foreseeable period of stability unleashes these dynamic impulses and fosters economic growth, but that if stability persists for too long, these impulses will gradually be dulled, and economic sclerosis will set in.

A flippant reaction to the Olson thesis might be that every country periodically requires a devastating war which, moreover, it must lose (if Great Britain's post-World War II economic experience is to be avoided)

or some similar convulsion. This, of course, is not a very helpful policy prescription. Other strands of Olson's thesis, however, have more obvious policy salience. He argues that absent his first-best state of the world — the absence of special interest groups (itself a debatable normative proposition)²⁵ — a second-best state of the world, in terms of economic performance, is one of peak or encompassing interest groups, especially business and labour, which are more likely to internalize costs of favoured policies than more narrowly focussed interest groups. Thus the existence of strong national labour and business interest groups are viewed as conducive to longer-term, more broadly conceived perspectives on economic policy making. As an adjunct argument, Olson suggests that one of the political advantages of free trade is that it tends to be subversive of entrenched, domestic, special interest groups. Thus free trade and institutional structures that promote peak or encompassing interest groups emerge as important policy implications of the Olson thesis.

Other commentators have developed similar lines of analysis with respect to public sector institutions. Thus it is argued that a strong centralized government, an expert and semi-autonomous (non-political) bureaucracy with sharply focussed policy-formulation and -implementation responsibilities and a centralized financial system are, like encompassing interest groups in the private sector, more conducive to broader, longer-term views of appropriate, national, economic strategies.

This institutional view of the determinants of economic growth, while perhaps initially attractive, on closer analysis seems less compelling. First, while there are obvious costs to "riotous pluralism," the fragmentation of power structures in both the public and private sectors may lead to government structures in which inter- and intra-jurisdictional competition yield high levels of innovation and experimentation in policy (West and Winer, 1980, p. 3), as well as reducing the possibility of large errors in policy that more monolithic government structures make possible. Similarly, more fragmented power structures in the private sector discourage the evolution of monolithic views of future industry welfare and encourage diversity, competition and innovation in business strategies.

In addition, to push the encompassing interest-group thesis to its limits leads one to the Nazi and Communist Parties or to one-party systems in Africa which presumably aspired or aspire to full internalization of all the costs and benefits of a country's policies, but with dubious economic results and less ambiguous consequences in terms of democratic values.

Another limitation of the Olson thesis is its failure to explain why large, private sector, peak interest groups are able to internalize economic costs and benefits of alternative policies better than political parties (themselves peak organizations), in the absence of these private sector, encompassing interest groups. One might hypothesize that, for

example, in large, centralized, closely integrated, labour organizations, regularity of interactions among repeat players in the formulation of policy preferences is more likely, over time, to induce a cooperative, "tit-for-tat," bargaining dynamic than log-rolling or full-line forcing among non-interacting interest groups in the political domain. Olson, however, does not address this issue.

The extent to which institutional integration in either the private or the public sector is an important influence on adjustment capacity is a question that will be re-examined in the concluding chapter of this study, in the light of the Canadian and comparative experiences.

We now turn to an extensive review of Canadian experience, to date, with adjustment policies in declining sectors, and we shall attempt to evaluate that experience against the conceptual framework developed in this chapter.



The Canadian Policy Approach to Declining Industrial Sectors

Introduction

Although tariff protection for import-sensitive industries has played a major role in the Canadian economy since the introduction of the National Policy of 1879, changes in the international economic order and technological innovations in the last two decades have seen government intervention take new and varied forms. Beginning with the Canada-U.S. negotiation of the Auto Pact in 1965, the Canadian government began to recognize the need, in some cases, for positive intervention, beyond mere protection from the competition of imports, in facilitating or accelerating capital and labour adaptation to rapidly changing market conditions.

Although the Automotive Products Trade Agreement (APTA), also known as the Auto Pact, was signed with the immediate view of avoiding U.S. retaliation to the Canadian government's duty-remission plans for automotive and automotive parts manufacturers, it also recognized the longer-run need to rationalize Canadian production with that of the United States. By the 1960s, European manufacturers had recovered from the effects of World War II and had fully re-entered the market. Canadian automotive companies, unlike those in the United States, could not respond by opening plants abroad because, as subsidiaries of U.S. companies, they were already part of the international network of the American companies. Although the Auto Pact was responsive to Canada's adjustment problems in the matter of Canada's trade with the United States, it did not address completely Canadian automotive concerns. The rising automotive balance-of-trade deficit outside the Pact as a consequence of low-cost imports has highlighted this deficiency and

has resulted in automotive interests demanding industry-specific government action beyond the existing adjustment policies. The imposition of "voluntary" export restraints on Japanese imports in 1981 was a response to these demands.

The textile, clothing, footwear and tanning industries have also suffered from an inability to compete effectively with low-cost imports. The regional concentration of these industries in Quebec and Ontario has provided an impetus for extensive government efforts to address adjustment problems. The 1970 Textile Policy and the 1983 Canadian Industrial Renewal Program, now under review, have probably been the most comprehensive attempts at adjustment policy the Canadian government has undertaken to date. Under these programs the textile, clothing, footwear and tanning industries have been protected from unrestricted imports, some restructuring of these industries has been encouraged, and adjustment assistance has been provided to displaced workers.

The problems faced by the Canadian shipbuilding industry have, in turn, been different from those faced by the automotive, textile, clothing, footwear and tanning industries. The concern, at least in part, has related to competition from low-cost imports, not necessarily deriving only from wage and productivity differentials, but also from foreign-government subsidization of exported ships. An incongruity has arisen in current subsidization policies in that domestic purchasers of Canadian ships receive assistance, in the form of construction subsidies, from only one source, while foreign purchasers of Canadian ships receive assistance from two sources, in the form of construction subsidies and financing assistance from the Export Development Corporation. As Canadian ship buyers can receive similar dual assistance from foreign governments, the present system contains a built-in incentive for Canadians to purchase their ships abroad. Members of the shipbuilding industry have also been critical of loopholes in the application of duty on foreign-built ships, the inconsistency of government programs across related industries (i.e., petroleum incentives and their effect on domestic ship sales), and the failure of the Canadian government to impose Canadian-content regulations on ships built for the Canadian Arctic and offshore exploration.

The formation of a Crown corporation in 1967 to deal with the adjustment problems of the Cape Breton coal-mining industry, in turn, has represented a quite different form of government intervention aimed at facilitating adjustment. The inability of Cape Breton coal producers to operate profitably if forced to compete without protection or subsidies and Cape Breton's dependence on the mines had, by the late 1960s, become a longstanding political dilemma, a dilemma which the federal government sought to solve by establishing a Crown corporation. Given the longstanding reliance of the Cape Breton economy on coal, the two divisions of Cape Breton Development Corporation (DEVCO) — The

Coal Division and the Industrial Development Division — were given initial mandates to phase down the coal industry on the island and simultaneously to develop alternative industrial and employment opportunities for Cape Bretoners (especially coal miners). Even though the oil crisis of 1973 and consequent increases in the price of coal served to change sharply the direction of DEVCO's Coal Division from one of contraction to one of development and expansion of coal production, the Industrial Development Division has continued to play a role in assisting the development of "grass-roots" industries and in attracting outside industries complementary to the Cape Breton economy. The Coal Division has itself assisted with the industrial development of the island by diversifying its activities beyond mining to include coal preparation and coal liquefaction.

Finally, the Canadian government has also pursued a number of non-sectoral or general adjustment policies. Such adjustment assistance has ostensibly been aimed both at reducing the cost of employment adjustment to workers and society by maintaining the workers' income levels during displacement and promoting their rapid re-employment, and at facilitating the adjustment of declining industries to meet a change in their competitive position. These programs include both short-run assistance in the form of income maintenance and long-run assistance in the form of retraining workers whose skills have become obsolete. To firms experiencing difficulties, last-resort financial assistance is provided through programs like the Enterprise Development Program (EDP), incorporated into the Industrial and Regional Development Program (IRDP) Division of the Department of Regional Economic Expansion (DREE) as of 1983, which finance plant modernization or corporate restructuring where private sector capital is not available. And in recent years, either through EDP or as a result of direct cabinet intervention, a number of firms experiencing severe financial difficulties have been bailed out through the provision of subsidies to assist in meeting operating costs. These firms include Canadair, Chrysler, Massey-Ferguson, Maislin Trucks, and White Implements.

The Policy-Making Process

As argued in the previous chapter, policy responses to the adjustment problems encountered by a nation will obviously not be determined exclusively or even primarily by the dictates of good economics or good ethics, but by the configuration of political forces to which the policy-making process is responsive.

The political forces at play in the industrial policy arena in Canada have been extensively described elsewhere,¹ but certain salient characteristics of the process can usefully be remarked at this point as a backdrop to the specific adjustment-related policies discussed in the body of

this chapter. What factors are likely to shape the nature of demands for policy responses to adjustment pressures? What factors, in turn, are likely to shape the policy responses to those demands?

It has been persuasively argued that open economies (like Canada's) that are more vulnerable to exogenous shocks from changes in the international economic environment will be led to heavier reliance on tax and expenditure policies, because of limited ability to countervail these shocks through domestic macroeconomic levers (Cameron, 1978). Even if this is so, however, a wide latitude still exists in terms of the choice of tax and expenditure policies that can be deployed to cushion adjustment pressures. As noted in Chapter 1, a substantial body of recent writing argues that more fragmented, private sector, interest-group structures will tend to promote narrowly focussed, defensive, adjustment-retarding policies, rather than more integrated and encompassing interest-group structures where the costs of favoured policies are more fully internalized to the interest groups promoting them and hence tend to reflect broader national perspectives.² In Canada, labour interests are weakly organized politically in several respects. First, only a little more than one-third of the work force is unionized at all. Secondly, the unionized segment of the work force is organizationally fragmented: there are 216 unions in Canada of which only 16 have over 50,000 members. Bargaining is heavily decentralized and typically takes place at the level of the firm rather than at the industry or national level as in some other nations. Thirdly, organized labour lacks a strong central or peak umbrella organization to concert its interests or to play a major role in corporatist structures of the kind that have emerged in several industrialized European economies; the Canadian Labour Congress appears to have very limited influence over its constituent union organizations. In the fourth place, organized labour has little direct political influence at the national level, as its formally preferred party, the New Democratic Party (NDP), for the most part is confined to a marginal and non-governmental role in national policy formulation. Thus, organized labour's demands for policy responses to adjustment pressures tend to reflect the interests of regional or local pockets of worker concentrations; their political salience tends to structure policy demands and responses around narrowly conceived interventions that externalize the costs to other more dispersed constituencies.

Organized business interests also tend to reflect sectoral and regional specializations and are not tightly integrated into strong national or peak organizations. The national organizations that exist, such as the Canadian Manufacturers Association and the Chambers of Commerce, tend to be extremely loose-knit federations of highly diverse and, indeed, divergent interests whose political articulation is typically left to more narrowly focussed sectoral or regional organizations.

While Canada's banking sector is heavily concentrated, as in Japan,

West Germany and France, the role of the banks has been largely confined to the provision of short-term credit to industry. Moreover, the absence of long-standing and intimate involvements in firms associated with the provision of substantial equity or long-term credit (as in Japan, West Germany, and France) has meant that the banking sector has not acted as a non-political buffer between industries facing a need for restructuring and government, in which role, it might apply early leverage to firms in difficulties to shed excess capacity and rationalize operations. Rather, the banks, as short-term creditors, have often applied significant pressure on government to adopt short-term interventionist policies to prop up firms in difficulty in order to safeguard bank interests (Trebilcock et al., forthcoming).

With respect to the factors influencing the nature of the policy responses to demands from these various sources, it is widely argued that the fragmentation of government authority has made governments prone to adopt narrowly focussed, defensive, adjustment-retarding policies, as multiple avenues of access to government influence promote narrowly based "clientele" effects across the different levels and agencies of government.³

Clearly, in this respect, Canada's relatively decentralized federal system severely exacerbates difficulties in forging a coherent national industrial strategy toward sectors of the economy under adjustment pressure. Substantial regional differences in wealth and, at least until recently, the regionally differentiated support bases of the two major federal political parties have led to what Simeon (1980) has called an emphasis on "vertical" divisions within the country and the spatial allocation of economic activities and employment. Provincial governments have often been induced to play the role of advocates of regional interests in dealings with the federal government or to adopt provincial policies protective of local interests where the costs of these policies have been, at least in part, externalized to cost bearers outside the jurisdiction ("beggar-thy-neighbour" policies). Federal government policies have often been no less sensitive to regional interests where these have been salient to maintaining the incumbent party's electoral support basis, and where costs can be externalized to extra-marginal voters in politically non-salient regions (Trebilcock et al., 1983). The lack of well-developed intergovernmental structures in the industrial policy field for integrating and reconciling regional perspectives with broader national economic objectives has reinforced a tendency to "ad hocism practiced with a vengeance" (Doern and Phidd, 1983, p. 409).

Apart from the constraints that a decentralized federal system imposes on the evolution of concerted national industrial policies toward declining sectors, fragmented roles and responsibilities within the federal bureaucracy have also made the concertation of federal policies difficult.⁴ During the 1960s, two departments had major policy-making

and administrative roles in the industrial policy field: the Department of Industry, which was concerned with the promotion of Canada's domestic manufacturing sector, and the Department of Trade and Commerce, whose principal concern was the development of export markets and international trade policy. These two departments were merged in 1969. However, a new department, the Department of Regional Economic Expansion (DREE), was created at the same time to promote economic activities in disadvantaged regions of the country. The orientations of these three institutional constituents of federal industrial policy making have been quite divergent. In 1982, DREE was merged with Industry, Trade and Commerce, while the international trade-policy responsibilities of the Department were transferred to the Department of External Affairs. In addition, the central agencies (Finance, Treasury Board, the Privy Council Office, the Prime Minister's Office) and other line departments such as Energy, Mines and Resources; Employment and Immigration; Transport; Fisheries; and Agriculture all have had policy-making responsibilities that have influenced the configuration of industrial policies. Beyond central agencies and line departments of government, the Tariff Board, the Textile & Clothing Board, the Anti-Dumping Tribunal, the Canadian Industrial Renewal Board, and the Cape Breton Development Corporation have had significant influence on policies toward sectors facing adjustment pressures.

Attempts to coordinate the policies of these various departments and agencies have been made, most notably in 1978, with the creation of the Board of Economic Development, which in 1982 evolved into the Cabinet Committee on Economic and Regional Development (comprising about 18 ministers). This board/committee was serviced by a secretariat called the Ministry of State for Economic (and later Regional) Development (MSERD), whose task was to attempt to integrate federal industrial policies. It appeared, however, to be unable to develop a substantial, independent, policy-formulation capability, and it largely confined itself to attempting — rather unsuccessfully — to secure consensus among the various constituent institutional players. It was abolished by the Turner government in 1984, and at this point it is not clear what agency, if any, is carrying out the integrative role assigned to MSERD.

The fragmentation of policy-making responsibilities in the industrial policy field within the federal government, frequent bureaucratic reorganizations, and entrenched "clientele" effects that are generated by mission-oriented agencies set up to service the needs of particular constituencies and often to act as an advocate on their behalf within government, have reinforced diffusion of responsibilities to different orders of government under the Canadian federal system. These factors have rendered acute the difficulties in the way of forging concerted, broadly focussed, long-range national policies that address the problems of declining sectors.

General Programs

National Manpower Policies

UNEMPLOYMENT INSURANCE

National manpower policies were historically seen as adequate to facilitate needed labour-market adjustments. Perhaps the most important of these national programs has been Unemployment Insurance, a program designed to provide short-term income replacement to enable unemployed workers to seek alternative employment. The current benefit levels of unemployment insurance are indexed for inflation and are based on 60 percent of the worker's average insurable earnings during the 20 weeks of employment preceding layoff. Depending on a community's unemployment rate, the program's entrance requirement varies from 10 to 14 weeks, and workers receive benefits for up to 50 weeks (OECD, 1984, p. 27). Total benefit payments for calendar year 1983 amounted to \$10.2 billion, and the average number of beneficiaries per month was 1,247,966.

CONSULTING SERVICES

Also addressed to both short- and long-run labour adjustments are programs such as the Canada Manpower Consultative Service (CMCS), now known as the Industrial Adjustment Service (IAS), which was established in 1964 to encourage management and labour to assume responsibility for worker adjustments where labour-force reductions or shutdowns are the causes of unemployment. As one of its many services, IAS provides mobility assistance. In particular, the program pays incremental costs of up to 50 percent if a firm seeks to relocate workers to other plants. Despite its broader potential, the vast majority of mobility grants under IAS have been for intra-firm transfers. The program has remained quite small.

IAS programs can go into effect prior to a layoff or plant closure. Because the federal government and a number of provincial governments require advance notice of significant layoff decisions, the local staff of IAS can use this information and contact the employer and union involved as soon as notification is received. If all parties are willing, a committee consisting of management and labour representatives, an IAS officer and a neutral chairperson is formed to seek the best possible solutions for adjustment. It is also possible for IAS to form industry-wide agreements to facilitate labour adjustments. Between April 1977 and April 1982, the number of IAS agreements rose from 339 to 427, and budget outlays increased from \$1.0 million to \$4.3 million (OECD, 1984, p. 28).

JOB PLACEMENT⁵

In terms of job placement, the past record of the Canadian government's main adjustment bodies, the Canada Employment Centres (CECs), is not particularly encouraging. A spokesperson from Employment and Immigration Canada reported in 1981 that 62 percent of job-seekers registered with the CECs receive no job referrals, and that only 18 percent actually obtain a job with CEC assistance (Saunders, 1984, p. 23). These figures are especially striking when viewed in light of the fact that workers receiving unemployment-insurance benefits must register with CEC in order to maintain eligibility. The ineffectiveness of CEC assistance is heightened further by employers' tendencies not to list jobs at CECs. The Parliamentary Task Force on Employment Opportunities for the 1980s reported that most employers do not list job openings with CECs because they view job applicants referred to them by CECs as generally people with poor work histories. Hence the number of job vacancies listed with CECs in 1980 was roughly on a par with the number listed with its predecessor in 1960, despite the growth of both the Canadian economy and the unemployment rate in the past two decades (*ibid.*, p. 26).

TRAINING PROGRAMS

For longer-term adjustment, several training programs are available. Many of these have been in place for some time, but were renamed and slightly modified under the *National Training Act* of 1982. Because most available data pertain to the pre-1982 situation, the state of retraining assistance will be examined as it existed before the *National Training Act* and later under the Act.

The federal government has been involved heavily in the financing of vocational training since 1960, when the *Technical and Vocational Training Act* was passed. Under that Act, the federal government initially paid 75 percent of the costs of the training, while provincial governments retained the responsibility for the type of training offered and its administration (Saunders, 1984, p. 33). The subsequent growth in the number of persons referred annually to training courses was dramatic, increasing from 8,000 in 1960 to 300,000 in 1966 (*ibid.*, p. 34). This division of functions between the federal and provincial governments changed somewhat with the passing of the *Adult Occupational Training Act* in 1967. Under that Act, the federal government was able to purchase some training services from private institutions, as distinct from public training institutions, if better quality was available for the costs. This generated opposition from provincial training institutions. A compromise was reached that consisted of a guarantee of a large percentage of the training funds for provincial institutions — private sector training schools account for only 3 to 4 percent of training days purchased — provincial

choice of course content for the provincial institutions, federal selection of adults to be trained, and administration by the CECs of the selection process (ibid.). The current Canada Manpower Training Program (CMTP) is largely based on the *Adult Occupational Training Act*.

The CMTP has two components, one institutionally based and the other employer based. The institutional program involves courses in provincial colleges and private vocational schools. A federal-provincial Manpower Needs Committee in each province determines the number of individuals to be trained in a given occupation. CMTP institutional trainees receive tuition and living allowances for a maximum of 52 weeks (Saunders, 1984, pp. 34–35). The employer-based part of CMTP, called Canada Manpower Industrial Training Program (CMITP), is in turn designed to alleviate shortages of skilled labour, to assist those who are in danger of becoming unemployed because of technological change or skill obsolescence, and to provide jobs to workers with special needs (that is, workers who would otherwise face difficulty in obtaining and holding permanent employment). Under this program the Canada Employment and Immigration Commission (CEIC) reimburses participating employers for up to 100 percent of direct training costs and for part of trainee wages — up to 40 percent for those who had previously been hired by the company, 60 percent for persons hired specifically for training, and 85 percent for special-needs workers (ibid., p. 35).

Finally, in the 1979/80 fiscal year, the federal government introduced a third program, a supplementary on-the-job training program called the Critical Trade Skills Training initiative (CTST). Under CTST a maximum of 50 percent of wage-subsidization and paid training costs are the vehicles used to promote the training of Canadian workers in highly skilled blue-collar occupations that experience chronic, acute, labour shortages. The occupations which are the focus of CTST change with labour-market conditions (Saunders, 1984, p. 35). The two tables below provide data on the institutional and industrial components of CMTP, CMITP and CTST.

It is apparent from these tables that institutional training continues to account for most training activity under the federal programs. In fact, the ratio of industrial trainees started to total trainees changed little from the fiscal years 1975/76 to 1981/82, despite the creation of CTST. The major change appeared to be one of expense, with expenditures on industrial training as a percentage of total outlays rising from 10 percent in fiscal year 1975/76 to 16.6 percent in the fiscal year 1981/82. Even then, however, actual expenditures on industrial training in Ontario were well below allocations; the remaining funds were transferred to the institutional training budget (Saunders, 1984, p. 66, note 15). Two features not shown in the table, but pointed out by Saunders, are that expenditures on the training programs stabilized in the late 1970s, after declining during the first half of the decade, and that the percentage of unemployed

TABLE 2-1 Institutional and Industrial Training: Program Expenditures

	1975/76	1976/77	1977/78	1978/79	1979/80	1980/81	1981/82	1982/83 ^b
Institutional training				(millions of dollars)				
Purchase expenditures	269.4	285.3	302.2	331.7	345.9	395.0	419.9	488.3
Allowances paid to trainees	186.3	200.2	190.8	117.0	84.2	103.6	105.7	113.3
Unemployment insurance	—	—	19.0	102.7	140.7	157.8	166.5	195.0
Subtotal	455.6	485.5	512.0	551.4	570.9	656.4	692.1	796.6
Industrial training	48.7	59.5	76.7	83.7	101.3	106.1	111.0	83.3
Critical trade skills	—	—	—	—	0.7	7.5	26.7	57.9
Training improvement program ^a	2.3	2.7	2.5	2.3	0.1	—	—	—
Total	506.6	547.7	591.2	637.3	672.9	770.0	829.8	937.9

Source: See R.S. Saunders, *Aid to Workers in Declining Industries* (Toronto: Ontario Economic Council, 1984). Tables A.5, A.6.

a. This program funded projects conducted by the provinces to improve the effectiveness and efficiency of training purchased by the federal government. It was terminated on 31 March 1979.

b. Figures for 1982-83 are allocations.

TABLE 2-2 Institutional and Industrial Training: Number of Trainees

	1975/76	1976/77	1977/78	1978/79	1979/80	1980/81	1981/82	1982/83 ^a
Institutional training	213,184	236,481	229,679	207,558	225,627	223,826	219,494	222,800
Industrial training	61,389	60,788	69,698	78,936	83,334	79,863	67,746	39,681
Critical trade skills	—	—	—	—	502	4,102	5,486	9,167
Total	274,573	297,269	299,377	286,494	309,463	307,791	292,726	271,648

Source: Annual reports of Employment and Immigration Canada data for 1981-82 and 1982-83, not published at time of writing, were provided directly by EIC.

a. Estimate.

persons among the institutional trainees rose from 50 percent in 1970 to 70 percent in 1980, reflecting the increase in the unemployment rate during this period (*ibid.*, p. 36).

In assessments of the adequacy of these training and retraining institutional programs, various concerns have been raised in studies undertaken by Employment and Immigration Canada (Canada, 1977a; 1982). One problem with the current institutional component of CMTP is the brevity of course duration. Despite a general recognition that lengthy training is required to acquire the middle- and high-level skills most in demand, the average duration of Canadian institutional skill training in 1979–80 was only 110 days (Canada, 1982, p. 15, Table 3-2). This brevity is largely caused by the federal limitation of cost-of-living support to 52 weeks and the tendency of courses to remain well within this limitation. This concern has been recognized in more recent policies, which allow for longer training periods. Another continuing concern has been with the inadequacy of living allowances allotted to trainees, especially for those trainees whose unemployment insurance has expired. Although this problem of inadequate living allowances has been mitigated since 1977/78 by allowing trainees to receive unemployment insurance in lieu of living allowances, as recently as 1974 the allowance for a trainee with a spouse and four children was below the social assistance level in all provinces except Nova Scotia and New Brunswick (Canada, 1977a, p. 30, Table 3).

A study undertaken in 1977 by Employment and Immigration Canada showed that for a 15-month period after the completion of training in 1975, there was an estimated average gain to trainees in earnings (attributable to training) of approximately 18 percent of the pre-training level. This study estimated the benefit-cost ratio at 3.5 for recipients who completed training in 1973, 3.4 for those who completed training in 1974, and 2.5 for those who completed training in 1975. These results have been criticized, however, for their optimistic assumption that the income gain would continue to retirement and for their failure to take into account the displacement effects of a graduate taking a job that might otherwise have been filled by an unemployed person (Saunders, 1984, p. 39). A study undertaken in 1982 attempted to correct these errors, adjusting for displacement effects and assuming that the net benefits would last only five years after training; it arrived at a benefit-cost ratio of 2.7 for persons who completed or discontinued training in 1978/79 (*ibid.*).

A recent analysis of CMITP, Canada's industrial training program, was also carried out by Employment and Immigration Canada (Canada, 1981b). This study, as with the 1982 assessment noted above, was based primarily on the findings of a 12-month follow-up survey of individuals who completed or withdrew from training in 1978/79. Given that the focus of our concern is with workers laid off from declining industries, the findings of the 1981 study used below refer only to the 44.5 percent of

those surveyed who were unemployed before the training began.⁶ The gains resulting from CMITP's on-the-job training were impressive. Those who completed training in 1978/79 were employed an average of 40.1 percent of the time during the 12 months preceding training and 83.9 percent of the time in the 12 months following it. And 12 months after the completion of training, the employment rate was 72.7 percent, with Quebec gaining the most in employability, with a 38 percent increase, and Alberta the least, with a 19 percent increase (Saunders, 1984, p. 40). All levels of trainees benefited from increased employability, and employability increased with skill level; those in apprenticeships gained 41.2 percent in employability, those in high-level skills gained 31.7 percent, and those in low- or medium-level skills gained 24.5 percent (ibid.). Finally, increased employability was accompanied by gains in weekly wages. CMITP trainees who were formerly unemployed and who finished their training in the 1978/79 fiscal year earned average weekly wages 43 percent higher than they had earned in the last jobs held before training. (About 15 percent of this increase was shared with other industrial wages because of inflation) (ibid.) Again, the gains were largest for younger trainees and for those who received either apprenticeship or high-level skill training. These results again emphasize the need for training beyond a one-year limit.

THE NATIONAL TRAINING ACT, 1982

The principal objective of the new *National Training Act* of 1982 was to increase the effectiveness of federal expenditures on training by targeting them on occupations that are in demand, rather than on the temporary removal of individuals from the ranks of the unemployed. The new system of training subsidies has the following features (Saunders, 1984, p. 43):

- It designates occupations with serious national or regional shortages as "priority occupations."
- It creates a Skills Growth Fund for capital funding of facilities for training in "priority" occupations.
- It continues the CTST program of two-year subsidies for on-the-job training in shortage occupations.
- It renames as the General Industrial Training program (GIT) the old CMITP subsidies of up to one year for other on-the-job training.
- It subsidizes continued training for apprentices who are laid off.
- It renames as the National Institutional Training Program (NITP) the old CMTP subsidies for institutional training and makes various adjustments aimed at increasing the number of workers trained in demand occupations.
- It relies on a new system of labour-market information, the Canadian Occupational Projection System (COPS).

To support the program's functioning, the government set aside \$108 million for the first two years of the new Skills Growth Fund to provide capital grants for the expansion or establishment of facilities for training workers in priority occupations. Only provincial institutions or private non-profit organizations are eligible for grants; training for skills in critically short supply in only a small local area is still covered by CTST rather than being deemed priority occupations and being held eligible for grants under the Skills Growth Fund. GIT funding, too, is supplied for only one year of training (unlike CTST funding, which is available for two years) and concentrates on training workers for occupations in demand, retraining workers affected by technological change or industrial restructuring, training the unemployed, training women in non-traditional occupations (that is, not in textiles or footwear industries), and training adults with special needs. Finally, the *National Training Act* assists apprentices laid off from training in critical skills so that they can continue their training, and establishes training contracts with industrial training councils (that is, groups other than employers) so that small employers may obtain training services that they otherwise would be unable to obtain (Saunders, 1984, p. 44). Although the National Institutional Training Program (NITP) replaced CMTP for the administration of institutional training, the types of training offered remain largely unchanged.

Preliminary statistics show that the \$938 million spent by the federal government in 1983/84 on training resulted in about 163,000 Canadians receiving some form of federal assistance to go back to school; 18,200 of these people secured a job related to their training within three months of course completion. However, only 61,000 of the 163,000 Canadians trained under the NITP were engaged in specific skill training with securing a job as the primary goal. Of the 61,000 involved in skill training for employment, 83 percent or 50,650 completed the courses, and 53 percent or 26,850 of those found jobs within three months of completing their training. Only 36 percent or 18,250 of those skilled trainees who completed courses found jobs related to their training. Of the 6,363 Canadians enrolled in high-tech training, only 800 of the 1,600 who found work within three months of course completion found jobs related to their training.

In Ontario alone, 50,000 people received federal assistance to go back to school in 1983/84, at a cost of \$147.9 million. Only 32,000 of these 50,000 Ontarians were full-time trainees. Only 26,560 of the latter group completed courses, 14,300 in specific skills. Sixty percent or 8,605 of the skilled trainees found jobs within three months, but only 5,737 of these were related to their training (Schiller, 1984).

Trainees not enrolled in skilled training under the NITP pursued such avenues as apprenticeship programs, English or French as a second language programs, or general academic upgrading. In all, the cost to the federal government of class seats in community colleges was \$500 mil-

lion in 1983/84. Trainees received income support during their training in the form of either unemployment-insurance benefits or training allowances. The cost of these allowances to the federal government was \$375 million, while capital expenditures on equipment and facilities totalled \$938 million (Schiller, 1984).

Under the *National Training Act* a new method of generating labour market information — the Canadian Occupational Projection System (COPS) — is designed to provide projections of imbalances in highly skilled occupations over a three- to 10-year period. The CEIC intends to overcome past difficulties in obtaining labour-market information by supplementing information from existing sources with information obtained from provincial governments, other federal departments, industry and unions. Cooperation with these groups, once achieved, will be enhanced further by the fact that priority occupations only will be designated by CEIC after it has consulted with these groups. What is not clear is the way in which COPS intends to acquire information on the supply side of the labour market, especially as it relates to interprovincial mobility and on-the-job training outside the provincial apprenticeship systems. On the demand side it is known that COPS' intention is to update information from the decennial census by means of special sectoral studies, as well as from information obtained from the provinces, unions, and industry (Saunders, 1984, p. 46). The key problem for COPS is not a new one: How is it to take account of informal training activities in industry? Saunders suggests that it perhaps should follow Ontario's 1978 initiative of creating decentralized Community Industrial Training Committees (CITCs) to initiate training programs and collect local labour-market information (and thereby identify more easily and more accurately information about labour supply and training sources) (ibid., p. 47).

MOBILITY PROGRAMS

Mobility assistance in Canada is currently provided by the Canada Mobility Program, which was established in 1967 as the Canada Manpower Mobility Program. Under this program, financial assistance for relocation is awarded to unemployed workers, under-employed workers and workers anticipating unemployment who must relocate. Exploratory assistance is awarded to allow workers to investigate job opportunities in other localities, and cash grants are given for part of the moving expenses for people who relocate to obtain jobs or to take training programs not available in the home area (OECD, 1984, p. 27). To be eligible for such relocation grants, the worker must show that he/she cannot find comparable work in the home community and is moving to a job in the nearest area where suitable positions are available. The amount of the grant (up to a maximum of \$3,000 in 1981/82) depends on

family size, distance travelled and the new salary. In addition, benefits were increased by 50 percent if the worker moved from a designated labour-surplus area to a hard-to-fill job. At the outset only 15 percent of the grant was made available to the worker before his or her departure to the new locality; the balance was paid after the move was completed. This practice was later changed, however, because of the hardship it created for low-income families; for these families the up-front payment recently has been increased to 50 percent.

Table 2-3 below gives data on program expenditures and numbers assisted in recent years (Saunders, 1984, Appendix, p. 57). In comparison to retraining assistance expenditures, total expenditures on the mobility programs are relatively small. Both the number of persons receiving benefits and the size of total program outlays (even in current dollars) appear to have decreased significantly in recent years. As regards expenditures under the mobility program, in the 1981/82 fiscal year, Table 2-4B shows that permanent relocation grants accounted for approximately 64 percent of total payments, with exploratory assistance, travel assistance and seasonal agriculture accounting for the bulk of the remaining payments (*ibid.*, p. 58).

A limitation in the Manpower Mobility Program as it presently exists is that it fails to provide a substantial incentive for a laid-off worker to relocate because it covers only part of the direct costs of moving. Glenday, Jenkins, and Evans (1982, pp. 40-43) point out that costs of moving, such as higher cost of living, loss of resale value on homes, and psychological costs of leaving friends and family, are recurrent and therefore of a higher present value than the one-time cost of transporting a household and its effects. The eligibility restriction of moving to the nearest possible area of employment may, in turn, exacerbate these problems as it does not leave the worker much option as to where he or she would prefer to move. Possible improvements to the program might be to allow the worker to choose employment within a wider area and to make the worker eligible for more assistance than mere compensation for direct moving costs. In some instances, perhaps, compensation might include at least partial coverage of any capital losses the worker incurs from selling his or her home. Yet other significant obstacles to the success of the mobility program appear to come from the provincial and municipal governments. The former tend to impede mobility through differences in provincial apprenticeship and professional qualifications, through preferential employment for provincial residents, and through opposition to federal out-migration policies because of a corresponding decrease in federal transfer payments to the provinces, since federal transfer payments are tied to population. The latter also tend to oppose out-migration policies because of the tendency of such policies to shrink the local tax base and thereby increase the average cost of servicing those citizens who remain behind, since out-migration jeopardizes economies of scale in providing local services.

TABLE 2-3 Canada Manpower Mobility Program: Number of Assistances Authorized and Expenditures ('000, current dollars)

	1975/76		1976/77		1977/78	
	Number	\$	Number	\$	Number	\$
Nfld.	4,514	922.6	12,122	1,283.2	3,015	1,302.0
N.S.	5,779	830.1	4,232	671.3	3,640	722.5
N.B.	2,292	440.3	3,834	395.5	2,147	540.9
P.E.I.	235	53.8	176	30.9	159	26.5
Que.	21,098	5,040.8	17,065	3,144.2	18,990	3,542.9
Ont.	6,884	2,347.1	34,977	1,466.2	11,345	2,302.2
Man.	725	437.4	830	192.1	2,736	202.9
Sask.	474	295.2	449	118.9	484	154.3
Alta. & N.W.T.	816	657.1	558	184.8	890	241.2
B.C. & Yukon	4,401	1,934.4	3,460	1,294.9	3,532	1,449.3
Total	47,218	12,958.9	77,703	8,782.0	46,938	10,484.9

	1978/79		1979/80		1980/81		1981/82	
	Number	\$	Number	\$	Number	\$	Number	\$
Nfld.	2,846	1,227.7	1,429	1,066.5	1,534	1,453.2	2,494	2,905.4
N.S.	3,850	650.5	2,808	745.5	977	646.3	2,058	851.2
N.B.	2,184	604.9	2,315	721.1	1,463	617.5	1,659	878.6
P.E.I.	166	41.2	167	32.0	211	102.5	316	160.6
Que.	16,961	3,271.3	15,356	3,122.1	7,309	1,360.0	9,488	2,056.0
Ont.	12,110	2,848.0	9,405	2,607.5	9,574	2,775.6	13,128	2,931.3
Man.	1,569	223.7	2,506	221.0	3,667	233.9	4,883	366.2
Sask.	658	167.5	366	127.5	255	77.7	297	110.1
Alta. & N.W.T.	788	229.0	385	138.3	232	89.4	247	79.7
B.C. & Yukon	4,343	1,478.4	1,927	785.5	940	372.7	1,088	412.4
Total	45,475	10,742.2	36,664	9,566.9	26,162	7,728.8	35,658	10,751.4

Source: Annual reports of Employment and Immigration Canada. (For data on number of assistances prior to 1977-78, see annual reports of the Department of Manpower and Immigration. The provincial breakdown for 1979-80 is not available in that annual report, but was provided by EIC.)

TABLE 2-4A Canada Manpower Mobility Program: Number of Assistances Authorized, 1981/82

	Relocation	Exploratory	Special Travel	Temporary Employment	Student Mobility	Seasonal Agriculture	Contingency Return	Total
Nfld.	1,143	387	304	569	11	79	1	2,494
N.S.	424	356	323	186	57	711	1	2,058
N.B.	529	244	65	265	25	528	3	1,659
P.E.I.	80	62	3	5	—	166	—	316
Que.	1,670	1,902	76	368	106	5,356	10	9,488
Ont.	1,947	1,396	254	370	173	8,938	50	13,128
Man.	200	341	64	11	2	4,243	22	4,883
Sask.	133	144	12	1	—	3	4	297
Alta. & N.W.T.	79	86	19	28	—	10	25	247
B.C. & Yukon	644	385	19	8	20	1	11	1,088
Total	6,849	5,303	1,139	1,811	394	20,035	127	35,658

TABLE 2-4B Canada Manpower Mobility Program: Expenditures in Dollars, 1981/82

	Relocation	Exploratory	Special Travel	Temporary Employment	Student Mobility	Seasonal Agriculture	Contingency Return	Total
Nfld.	2,530,603	164,676	10,311	176,664	3,590	17,447	2,100	2,905,391
N.S.	537,475	162,037	12,617	85,088	20,618	32,194	1,142	851,171
N.B.	595,779	105,639	5,113	86,580	8,215	76,436	804	878,566
P.E.I.	116,073	35,100	234	2,110	—	7,053	—	160,570
Que.	856,764	466,234	3,002	76,788	22,628	629,498	1,081	2,055,995
Ont.	1,617,570	473,598	14,126	70,979	41,235	695,962	17,828	2,931,298
Man.	162,326	106,868	5,655	2,205	59	47,061	42,019	366,193
Sask.	70,474	36,931	573	360	—	145	1,650	110,133
Alta. & N.W.T.	40,826	26,364	2,245	1,686	—	800	7,789	79,710
B.C. & Yukon	303,584	94,706	3,261	1,766	3,304	113	5,674	412,408
Total	6,831,474	1,672,153	57,137	504,226	99,649	1,506,709	80,087	10,751,435

Enterprise Development Program

In addition to national employment policies, there exist several other adjustment-assistance programs of a general nature. Established in 1977, the Enterprise Development Program (EDP) was intended to integrate several programs in the Department of Industry, Trade and Commerce (ITC). These programs had varied from narrowly focussed ones such as Automobile Manufacturers' Assistance, the *Pharmaceutical Assistance Act* and the *Footwear and Tannery Act* to broader-based programs such as the Program for the Advancement of Industrial Technology (PAIT). The integration of such programs had several purposes beyond the coordination of industrial development arrangements. First, assistance was broadened to include firms other than large firms located in Central Canada. Secondly, the new EDP sought to promote more local and private sector participation in decision making by providing for decisions to be made by 11 Enterprise Development Boards (ten regional and one central), each of which was to consist of an equal number of private and public sector members. The regional boards, unlike the central board, could not authorize assistance above \$200,000. The central board handled larger submissions and was divided into two committees, the Innovation Assistance Panel and the Adjustment Assistance Panel, which reflected the dual purposes of the EDP: to foster innovation in the design and development of new or improved products and to assist firms to adjust to changing competitive circumstances.

The projects funded by grants or contributions under the EDP were intended mainly to promote innovation. Although, arguably, some innovations may be critical to firm survival, it is the adjustment side of the EDP, under which the government provides loans and/or guarantees as lenders of last resort, that is of particular relevance to this study. In order to qualify for assistance, a company had to show that government funding was necessary for the project to be undertaken, or that investment would place a significant burden on the firm. A project would be judged to represent a significant burden to a firm if its failure would place the firm in financial jeopardy, or if it would not be undertaken without assistance because the firm faced other commitments for its funds. Under last-resort lending, the assistance was based on the presumption that the firm had exhausted all other sources of funding. As of March 31, 1982, outstanding loan guarantees and loans to the private sector under the EDP amounted to \$101.1 million and \$7.9 million respectively (Maslove, 1983, p. 126).

The EDP's performance has been the subject of a number of criticisms. In the 1982 Auditor General's Report, the EDP was criticized for its vague objectives, for the wide discretion it enjoyed in implementation, and for the limited evidence of monitoring to ensure compliance with conditions of assistance. The Auditor General reported that no operating guidelines existed for the Boards governing what constituted an acceptable level of

risk or economic benefit for Canada. Furthermore, the Report suggested that when the government assumed part of the ownership interests in a firm, decisions on future assistance should be made independently of the Department.

A number of recent federal bail-outs of failing private sector firms have been administered under the EDP or elsewhere within the Department of Regional Industrial Expansion (DRIE), often following a direct cabinet decision favouring assistance; the firms assisted include Chrysler, Massey-Ferguson, Canadair, de Havilland, Maislin, Canada Cycle and Motor Ltd., White Farm Equipment Ltd., Electrohome and Consolidated Computer. The firm among this group representing the largest bail-out is Canadair, primarily a manufacturer of executive jets and water bombers, which was acquired by the federal government from General Dynamics in 1975, when its closure was thought likely. The purchase price was \$38 million; prior subsidies amounted to \$65 million, subsequent equity infusions of \$550 million have been provided, and the government has recently assumed all \$1.5 billion of Canadair's debts. This amounts to a total public outlay of about \$2 billion, without accounting for substantial government procurement directed to the company. At the time of the initial buy-out in 1975, employees of the company numbered about 2,400. Employment stood at about 4,500 at the end of 1983. Critics of this bail-out have argued that it would have been cheaper to give every member of the Challenger executive jet work force \$60,000 a year for life than to provide subsidies on this scale. Moreover, it was claimed that by mid-1982 the federal government's \$1.5 billion involvement in Canadair amounted to more than that government had spent on job-creation and retraining programs throughout Canada in 1982 (Trebilcock et al., forthcoming).

The Industry and Labour Adjustment Program

In response to criticisms of the narrowness of adjustment assistance outside the textile, clothing, footwear and tanning industries, the federal government, in its October 1980 budget, created another general program, the Industry and Labour Adjustment Program (ILAP). It projected expenditures of \$350 million (later increased to \$450 million) over four years to promote industrial restructuring and manpower training and mobility in sectoral and regional areas of particular need. Under this program, affected industries such as farm machinery, autos, shipbuilding, primary metals, and pulp and paper were presumed to be unable to undertake, without government assistance, viable projects which were in the best economic interests of Canada. The focus of the program was on communities which were heavily dependent on a particular major industry and hence were subject to severe dislocation in the event of large-scale layoffs.

In the community-designation process, both the size of the industry/

sector layoff and its effect as a proportion of the community's work force were considered. The dislocation requiring adjustment assistance had to have occurred in the preceding three years, had to be permanent, and could not have been a long-standing situation. (On this last point, for example, the Cape Breton coal-mining industry probably would not have been eligible.) The characteristics of the affected work force and the proximity to a larger, stronger, labour market were also considered. Twelve communities, most of which are in Ontario and Quebec, were designated under ILAP to receive assistance.

ILAP proposed a two-fold response to adjustment problems, one part for labour and one part for industry; it provided a safety net to the unemployed, as well as assistance to restructure industries. The Department of Industry, Trade and Commerce administered the industry portion under the then-existing Enterprise Development Program (EDP), while Employment and Immigration Canada and Labour Canada jointly administered the labour portion. As of 1983, however, the Industrial and Regional Development Program (IRDP) subsumed EDP, and upon ILAP's expiration on March 31, 1984, IRDP was expected to replace it also.

The significant point about the community-based approach to adjustment in general is that the effect of the adjustment process on the community, rather than on an industry, determines the extent of assistance available. Under ILAP, community-based labour-adjustment measures included:

- enhanced training allowances under the National Institutional Training Program for workers whose occupations are no longer in demand;
- a 10 percent increase up to a maximum of \$240 per week for weekly income-maintenance allowances to both those receiving unemployment insurance and to those whose benefits had expired (OECD, 1984, p. 32);
- portable wage subsidies (PWS) of up to \$2 per hour to displaced workers who were 45 years of age or over, who had at least two years of employment with the affected firm, and who had little prospect of re-employment. Available for up to 12 months, the PWS was payable to the employer who hired the worker; the position obtained was to pay the going rate for that type of job and was not to displace any employees of the hiring firm;
- a three-fold increase in the mobility allowances of the Canada Manpower Mobility Program which assists in covering temporary and permanent relocation costs of workers and their dependents, to a maximum of \$9,000; and
- temporary employment was provided for displaced workers who had exhausted their unemployment-insurance benefits at 20 percent more than the provincial minimum wage. This employment was provided through a Community Employment Program (OECD, 1984, p. 33; Saunders, 1984, p. 48).

As part of the expansion of adjustment measures under the ILAP, the early pre-retirement benefits to displaced workers aged 50 years and older under the Labour Adjustment Benefits (LAB) Program were made available to workers in ILAP-designated communities and industries. The LAB program had operated independently before becoming a component of ILAP, providing pre-retirement benefits to workers in the textile, clothing, footwear and tanning industries. It consolidated the former Adjustment Assistance Benefits (AAB) program (discussed with respect to textiles) while introducing greater flexibility with respect to eligibility criteria. Pre-retirement benefits were provided to eligible workers between 50 and 65 years of age who had been displaced as a result of either import competition or structural changes in industries designated for assistance. To be eligible, these individuals had to have been employed in the designated industry for at least 10 years preceding layoff and have either no prospect of employment or have accepted employment with earnings less than their previous insurable earnings. Once unemployment-insurance benefits had run out, the recipient could receive benefits of 60 percent of her or his average weekly insurable earnings prior to layoff until she or he found employment or reached the age of 65. A bi-annual review of the claimant's employment opportunities was then held to ensure that LAB benefits were a last-resort income-maintenance measure (OECD, 1984, p. 33).

Although ILAP appeared to be an improvement over adjustment assistance previously available, it proved in many ways still to be of limited effectiveness. Its limited budget meant that only a small number of communities were designated for aid and even then for only a short time. Moreover, the mobility allowance, although greatly increased, remained inadequate insofar as it did not allow for relocation losses such as capital losses on the sale of housing. It is not surprising, therefore, that use of ILAP's labour-adjustment assistance measures was more limited than its budget allowed. From March 1981, when the first community designations were made, to March 1983, approximately 18,650 workers were eligible to take advantage of the program. Of those who did so, most participated in the Community Employment Program (2,354) and industrial training (1,363). Only 637 workers participated in institutional training and received enhanced living allowances. Further, while 1,721 vouchers were issued under the portable wage-subsidy program, only 175 workers aged 45 and older managed to become re-employed. Finally, mobility allowances were granted only to 108 workers, and although at the end of 1982, 799 workers over the age of 54 years and 279 workers aged 50 to 54 in 11 designated ILAP communities were certified as eligible for LAB, only 489 claims were filed and even fewer (144) were allowed for a total cost of \$100,000 (OECD, 1984, pp. 34-35).

As we have noted, ILAP included measures to promote industrial adjustment as well as labour adjustment. The Enterprise Development Program (EDP) was the program under which ILAP industrial assistance

was provided, and under EDP the most important eligibility criteria for adjustment assistance were that a firm's proposed project or projects constitute a "significant burden" on its resources, or that the government be the lender of last resort. These criteria ensured that EDP financing in the form of loans, loan insurance and/or grants represented last-resort support and assistance that supplemented rather than supplanted private sector resources. Finally, the firm and its projects had to be commercially viable as defined by the "corporate approach" analysis of the EDP Board, and the assistance to the designated community had to be seen as resulting in net economic benefits without creating over-capacity in the industry concerned.

Particular forms of industrial assistance provided under ILAP included (Canada, 1985, Appendix B):

- contributions of up to 75 percent of consultant costs of projects to establish, expand or restructure operations;
- contributions of up to 75 percent of consultant costs associated with merger and acquisition projects;
- contributions of up to 75 percent of consultant costs for operational analysis and restructuring plans;
- repayable interest-free contributions of up to 50 percent of capital costs to cause the project to be undertaken;
- Critical Trade Skills Training (CTST) available to firms participating in the training program; this included 100 percent of trainee wages to a maximum of \$250 weekly (for the first year).

The industrial assistance measures provided under ILAP were used more extensively than ILAP's labour-adjustment programs. As of December 1983, funds approved under ILAP (both labour and industry programs) amounted to \$79 million and were claimed to have created an estimated 8,000 jobs (Canada, 1985, Appendix B). Most of the assistance appears to have gone to firms in an attempt to induce them to maintain employment or to locate in designated communities; moreover, most of the labour-adjustment assistance was directed toward the creation of only temporary employment in these communities. When ILAP legislation expired on March 31, 1984, ILAP lapsed as an independent program and was subsumed into the Industrial and Regional Development Program (IRDP), to which we shall now turn.

Industrial and Regional Development Program

In January 1982, the federal government announced the restructuring of federal departments and agencies concerned with economic development. Central to this reorganization was the creation of the Department of Regional and Industrial Expansion (DRIE). It was formed by amalgamating the regional programs of the Department of Regional Economic Expansion (DREE) and the industry, small business and tourism

components of the Department of Industry, Trade and Commerce (ITC). The core program of DRIE, the Industrial and Regional Development Program (IRDP), became effective July 1, 1983; it delivers direct assistance to private sector firms through grant contributions, repayable contributions, participating loans and loan guarantees. The goal of this assistance is to make Canadian industry more competitive in order to maximize its potential in domestic and foreign markets. The program is directed at small and medium-sized firms and at regional concerns. On its establishment, IRDP subsumed several of the former federal government assistance programs, among which were the Enterprise Development Program (EDP), the Regional Development Incentives Program (RDIP), the Institutional Assistance Program (IAP), the Support for Technology Enhanced Productivity (STEP), the Cooperative Overseas Market Development Program, (COMDP) and the special area programs for Montreal and the Magdalen Islands (Canada, 1985, Appendix B).

IRDP assistance is available to firms in all regions of Canada. As long as the activity is undertaken in Canada, individuals, associations, partnerships, co-operatives, bodies corporate and non-profit organizations are eligible for this assistance. IRDP provides financial assistance for eligible projects involving six elements of a product or company cycle: industrial infrastructure, innovation, establishment, modernization/expansion, marketing, and renewal.⁷ Following the determination of a project's eligibility, priorities for targeting program support are set, after consultation with the private sector and other interested persons. Project proposals are then ranked in accordance with the priorities chosen and the project's net economic benefits. As with other government assistance programs, the evaluation criteria for IRDP include incrementality (that is, no project will be supported unless it would be unlikely to proceed in its proposed location, scope or timing without support), the project's commercial and economic viability, and significant net economic benefits to Canada (Fantham and Doherty, 1983, p. 81).

In order to determine the amount of assistance available, a development index classifies Canada's 260 census divisions into one of four Tier Groups according to economic disparity. The index is based on the following circumstances (Canada, 1983b, Appendix, p. 1):

- the level of unemployment in a district (based on cumulative averages beginning with 1976 available data);
- the level of income per person in a district (based on cumulative averages beginning with 1978 available data);
- the fiscal capacity of the province in which the district is located (based on averaging annual available data).

These three factors are then assigned different weights so as to reflect the traditional measurements of economic hardship employed by other statistical bases.

The index has been used to develop a graduated four-tier system of

financial aid: the level of assistance that a firm receives depends on what tier it is in. Though the regions designated in tiers will change with time and development, the tiers themselves are defined as follows (Canada, 1983b, Appendix, p. 2):

- Tier IV: those regions in which the 5 percent most economically disadvantaged Canadians reside;
- Tier III: those regions in which the next 5 to 20 percent of economically disadvantaged Canadians reside;
- Tier II: those regions in which the next 20 to 35 percent of the population resides;
- Tier I: those regions in which the remainder of the population resides.

Provisions exist for enhanced programming in areas experiencing acute short-term problems. Hence if the unemployment to labour-force ratio for a Tier I region exceeds the national average by 1 percent for any consecutive six-month period, that region will be eligible for Tier II assistance for one year (Fantham and Doherty, 1983, p. 82).

The new Department's budget of \$2.5 billion over two years far exceeds ILAP's \$350 million over four years, although this budget figure covers all projects under the former Department of Industry, Trade and Commerce and Regional Economic Expansion (Canada, 1983b, p. 2). The total of the \$2.5 billion that will actually be expended on industrial development and labour-adjustment policies still remains to be determined.

Provincial Industrial Assistance Programs

Although the provinces have sponsored many industrial assistance programs, some with an adjustment orientation, the highest percentage of industrial assistance expenditures have been made by the federal government: grants accounted for 79 percent (1978/79); loans and investments for 74 percent (1980); loan guarantees and credit insurance for 95 percent (1980) (Trebilcock et al., forthcoming, chap. 2). For this reason provincial industrial assistance programs will not be dealt with in this paper.

Conclusions

Unemployment Insurance Commission (UIC) expenditures overwhelm all others in relation to non-sectoral government programs for displaced labour. UIC made expenditures in 1983 of \$10.2 billion, compared to \$937 million in 1982 on the Canada Manpower Training Program (institutional and industrial training), \$10.7 million on the Canada Manpower Mobility Program in 1981/82, and \$4.3 million on the Canada Manpower Consultative Service in 1982. While unemployment insurance undoubtedly facilitates job search in some respects, most of the available evi-

dence suggests that it also increases the overall employment rate by some 1 or 2 percent. Indeed, unemployment insurance appears to be support oriented rather than adjustment oriented. It has not been conditional on participation in retraining or relocation programs. The effectiveness of the Canada Manpower Training Program has itself yielded mixed assessments. Some studies indicate that trainees benefit from substantial improvements in subsequent employability and wage rates under that program, while recent data, undoubtedly reflecting the generally depressed nature of the economy and high unemployment rates, are not as encouraging.

The Industrial and Labour Adjustment Program which operated from 1981 to 1984 and which was directed at designated distressed communities was short term in its objectives and appears to have made little progress in facilitating longer-term structural or labour adjustments. Most of the assistance appears to have been granted to firms to induce them to maintain employment in the designated communities or to locate in these communities, while direct assistance to labour appears to have been directed principally at creating temporary employment opportunities in the distressed communities.

With respect to non-sector-specific government programs designed to assist firms facing financial difficulties, much of the assistance (principally provided under the Enterprise Development Program) appears to have been provided on a crisis basis to the weakest and least efficient firms in an industry, to have been motivated principally by short-run employment considerations, not to have strongly focussed on inducing structural adjustment necessary for long-term viability (the bail-out phenomenon), and rarely to have adopted an industry-wide perspective in employing assistance as leverage to induce industry restructuring through such means as mergers, rationalizations and scrapping of physical capacity. Thus, for example, three ailing farm-machinery companies, Massey-Ferguson, White Farm and Cooperative Implements, have received federal assistance despite serious over-capacity at both the firm and industry levels. Moreover, the heavy reliance on loan guarantees and loan insurance as the instruments of assistance (an off-budget expenditure) has often exacerbated the already over-leveraged situation of firms seeking assistance (Trebilcock et al., forthcoming, chap. 11).

Sectoral Programs

The Automotive Industry

BASIC CHARACTERISTICS

The history of the Canadian automotive industry is one of government intervention aimed at the expansion and rationalization of the industry.

Throughout the industry's development, any threat to Canada's share of domestic production and value-added has been countered by trade and domestic policies for automotive investment, production and employment in Canada.

This continuous governmental involvement is partly explained by the pivotal role which the automotive industry plays in the Canadian economy. The high degree of industrial and regional concentration and of unionization has also made the industry one whose demands on government have high political salience. The industry is Canada's largest manufacturing sector, producing nearly \$18 billion worth of goods in 1982, and employing 8 percent of all Canadian manufacturing employment: 103,000 workers in 1982 and about 125,000 currently (Canada, 1983c, p. 1). Automotive vehicles and components have also constituted about 60 percent of Canada's exports of manufactured end products (*ibid.*, p. 3).

The automotive industry employs almost as many workers indirectly as directly. It is the largest single purchaser of a number of processed raw materials, consuming over one-sixth of the nation's iron and steel production, rubber products and batteries, as well as 14 percent of processed aluminum and 13 percent of processed copper. It also purchases large quantities of fabricated products, consuming 15 percent of all machine-shop production, 13 percent of wire products, and 13 percent of metal casting and extruding, 8 percent of metal stamping, 4.7 percent of plastics, and 3.8 percent of textile production (Canada, 1983c, p. 4). Perhaps the most crucial of these linkages is that to Canada's iron and steel industry, the bulk of whose automotive-oriented production is purchased by Canadian parts manufacturers. The continued viability of the iron and steel industry is of great importance to Canada because of its employment of 50,000 workers, its Canadian ownership, and its close linkages to the mining, resource and transportation sectors. Eighty-three percent of total steel production is centred in Ontario and 12 percent in Quebec. Any contraction in the automotive industry is likely to have significant effects on iron- and steel-based communities in these provinces (*ibid.*, p. 12).

Tables 2-5 and 2-6 indicate trends in Canada's automotive industry over the past 30 years.

The value of shipments of motor-vehicle manufacturers increased by 1,260 percent from 1955 to 1982. Employment in the motor-vehicle manufacturing industry grew from 1955 to 1975 and thereafter declined; however, the employment level was about 24 percent higher in 1982 than it was in 1955. The number of establishments manufacturing motor vehicles also grew from 1955 to 1975 and thereafter decreased somewhat. From 1955 to 1982 these establishments increased by 40 percent, but the four-firm concentration ratio remained constant and high at over 90 percent in roughly the same time period.

TABLE 2-5 Trends in Canada's Automotive Industry

Products	1955	1965	1975	1980	1982
Motor Vehicles					
No. employees	33,429	42,432	45,256	44,870	1,600
Value of shipments (\$'000)	907,411	2,120,302	6,024,429	10,071,053	12,343,581
No. establishments	15	20	24	22	21
Motor Vehicle Parts and Accessories					
No. employees	19,996	31,982	42,639	46,326	48,050
Value of shipments (\$'000)	285,071	755,608	2,325,802	3,609,683	5,059,731
No. establishments	188	160	231	342	354
Truck Body and Trailer Mfrs.					
No. employees		5,432	17,688	14,824	9,683
Value of shipments (\$'000)		103,012	774,108	977,636	744,025
No. establishments		160	293	348	284
Truck Body Manufacturers					
No. employees			5,428	5,793	4,533
Value of shipments (\$'000)			197,235	316,497	311,853
No. establishments			130	146	132
Non-Commercial Trailer Manufacturers					
No. employees			9,385	4,756	2,692
Value of shipments (\$'000)			459,910	359,286	260,689
No. establishments			128	141	99
Commercial Trailer Manufacturers					
No. employees			2,875	4,275	2,458
Value of shipments (\$'000)			116,963	301,854	171,484
No. establishments			35	61	53

Sources: Dominion Bureau of Statistics, *The Manufacturing Industries of Canada, 1955*, Section A (Ottawa: Queen's Printer, 1957), pp. 20-21; Dominion Bureau of Statistics, *The Manufacturing Industries of Canada, 1965*, Section A (Ottawa: Queen's Printer, 1968), pp. 30-31; Statistics Canada, *Manufacturing Industries of Canada: National and Provincial Areas, 1975* (Ottawa: Minister of Supply and Services Canada, 1977); Statistics Canada, *Manufacturing Industries of Canada: National and Provincial Areas, 1980* (Ottawa: Minister of Supply and Services Canada, 1982), pp. 8-9; Statistics Canada, *Manufacturing Industries of Canada: National and Provincial Areas, 1982* (Ottawa: Minister of Supply and Services Canada, 1984), pp. 8-9.

TABLE 2-6 Concentration in Canada's Automotive Industry

	1954	1958	1965	1968	1970	1972	1974	1976	1978	1980
Motor vehicles	95.4	95.8	93.3	94.6	93.3	—	90.1	93.4	93.6	93.7
Motor-vehicle parts and accessories	—	—	54.2	49.7	46.2	48.9	46.2	50.2	54.5	44.6
Truck-body manufacturers	—	—	—	—	36.9	33.2	32.1	36.9	36.3	36.1
Non-commercial trailer manufacturers	—	—	—	—	46.3	49.5	40.5	39.2	36.1	39.9
Commercial trailer manufacturers	—	—	—	—	69.9	—	67.5	—	57.5	53.4

Source: Statistics Canada, *Industrial Organization and Concentration in the Manufacturing, Mining, and Logging Industries, 1980* (Ottawa: Minister of Supply and Services Canada, 1983), pp. 61-62.

Note: The percentage of all shipments accounted for by the four largest enterprises in each industry.

The value of shipments of manufacturers of motor-vehicle parts and accessories increased greatly, by 1,674 percent, from 1955 to 1982. Employment in the motor-vehicle parts and accessories industry increased greatly, by 190 percent, in the same time period; in fact, by 1980, more persons were employed in this industry than in the motor-vehicle manufacturing industry itself. The number of establishments producing motor-vehicle parts and accessories increased by 85 percent between 1955 and 1982, while the four-firm concentration ratio declined by almost 10 percent from 1965 to 1980.

GOVERNMENT INTERVENTION IN THE AUTOMOTIVE INDUSTRY BEFORE THE AUTO PACT

The importance of the automotive industry to Canada and the government's protection of that industry are not new phenomena. Between 1918 and 1923, with the aid of tariffs as high as 35 percent, Canada was the world's second-largest producer of motor vehicles. Although dominated by the affiliates of the American pioneers — Ford, Buick, Chevrolet and Chrysler — which were encouraged to locate branch plants in Canada because of the high tariffs and British preferential treatment, the sector depended, prior to 1960, on vigorous export trade with overseas countries and on high rates of domestic protection. The large numbers of imported engines and other key components produced by the American affiliates for these exports did not manifest itself as a problem until the late 1950s, when Europe's postwar recovery, the subsequent decision by North American manufacturers to construct production facilities on the European continent, Canadian economic conditions, and the reluctance of Canadian-located manufacturers to produce small cars combined to create a balance-of-trade crisis in the Canadian industry. The auto-trade deficit of 1960 accounted for \$500-million worth of the nation's \$1.2-billion total current-account deficit (Canada, 1983c, p. 16).

The dilemma facing government policy makers at this time, therefore, was to encourage the automotive industry to invest in Canada, without promoting the development of an inefficient branch-plant industry structure and without continuing the upward pressure on prices that the tariff-based approach implied. Hence, following such domestic responses as a 1957 reduction in the excise tax on automobiles and a 1959 demand by government that manufacturers produce small cars in Canada, the Canadian government followed the recommendations of the Bladen Royal Commission on the Automobile Industry in 1960. Thus, in late 1962, it introduced the first of two duty-remission plans designed to stimulate exports of auto products (Kirkton, 1980–81, p. 44). Under this plan, the duty that a Canadian producer of vehicles paid on imports of automatic transmissions and stripped engines would be remitted, dollar for dollar, to the extent that the Canadian content of all automotive parts exported

by the producer exceeded that of the designated base period. The next year the plan was extended to include all imports of motor vehicles and original equipment parts. These plans proved quite successful in increasing Canadian automotive exports, especially to the United States. U.S. imports of Canadian parts increased from \$8 million in 1962, to \$18 million in 1963, to \$27 million in 1964 (Helmets, 1967, p. 13).

Not surprisingly, the Canadian remission plans and consequent increased exports to the United States aroused strong opposition from American independent producers of parts for the auto industry. Not only did the plans fail to distinguish between replacement parts and original equipment parts, but they had been adopted unilaterally by the Canadian government without consultation with the U.S. government. The American parts makers consequently petitioned for a countervailing duty on imported parts on the grounds that the duty remission amounted to a "bounty or grant" under the terms of the *United States Customs Act* of 1930. The 1965 Automotive Products Trade Agreement between Canada and the United States was an attempt to forestall the possibility that these countervailing duties might be applied in the United States, and that Canada might engage in further retaliatory action. Upon signing the Agreement, Canada immediately revoked the duty-remission plan.

THE AUTOMOTIVE PRODUCTS TRADE AGREEMENT

The Automotive Products Trade Agreement (APTA), also known as the Auto Pact, essentially embodied a recognition of the need to rationalize Canadian production of both parts and vehicles with that of the United States so as to enable Canadian industry to participate more effectively in a larger North American market. This development was of particular importance, since Canada, unlike the United States, could not solve its problem of declining European exports by opening plants abroad, as the Canadian companies were, in fact, part of the American international network. Although the Agreement provides for freer trade than was the norm before its enactment, it does not provide for a complete dismantling of trade barriers. The United States is committed to accord duty-free treatment to Canadian exports of motor vehicles and of parts for use as original equipment in the manufacturing of motor vehicles in the United States. Limitations imposed by the United States with respect to this duty-free access included the exemption of certain special-purpose vehicles, exclusion of replacement parts and parts sold in the after-market for servicing — this is important as it leaves a large part of the American parts industry protected — and a 50 percent North American content requirement for Canadian exports before they qualify for duty-free entry. In return, Canada is committed to accord duty-free treatment to American exports of motor vehicles and parts for use as original equipment in the manufacture of motor vehicles. The following three conditions were agreed to:

- Companies making cars or trucks in Canada can participate under the Pact.
- Each designated manufacturer must maintain a certain ratio between the net sales value of vehicles made in Canada and the net sales value of vehicles sold here (75 percent or the level achieved in the base year beginning August 1, 1963, whichever is greater).
- The amount of Canadian value-added for all classes of vehicles made in Canada is to be at least as great as the amount that was achieved in the base year (Canada, 1983c, pp. 17–18).

The Canadian government also obtained collateral assurances from the Canadian motor-vehicle manufacturers to ensure the Canadian automotive industry an equitable share in the expansion of the North American motor-vehicle market. They undertook:

- to increase the dollar value of Canadian value-added in the production of vehicles and original equipment parts in each model year compared to the preceding model year by at least 60 percent of the growth in the value of cars and 50 percent of the growth in the value of commercial vehicles;
- to increase collectively the amount of value-added in Canada by \$241 million by the end of 1968 (Helmets, 1967, p. 23).

In sum, these safeguards were to guarantee additional manufacturing activity in Canada without putting upward pressure on prices.

Although the United States initially agreed to the inclusion of the Canadian safeguards governing production and Canadian value-added, Canada came under pressure to remove the safeguards in the late 1960s and early 1970s. This pressure dissipated in the mid-1970s, however, when the balance of trade for automotive products and parts shifted heavily in favour of the Americans. In the last several years, this balance has again shifted in favour of Canada, mainly as a result of large investments such as the Canadian production by Chrysler of a mini-van for the entire North American market.

EFFECTS OF THE AUTO PACT

The Auto Pact has brought some positive results for both Canada and the United States. It has enabled the American automotive companies to maintain a dominant share of the world's seventh-largest vehicle market, and it has brought Canada more production, expanded trade, increased productivity, a greater share of North American automotive employment, and lower consumer prices. Employment rose from 70,600 in 1964 to 124,000 in 1979, falling back to 103,000 in 1983, in the wake of the recession and rising again to current levels of 125,000. Canadian value-added has risen from 3.7 percent of the North American value of automotive output before the Auto Pact to 5.2 percent in 1971 and to 6.9 per-

cent in 1981 (Canada, 1983c, p. 21). In addition, both the productivity and price-before-sales-tax gaps which existed in the United States' favour before the Pact have been virtually eliminated (ibid., p. 22). Moreover, the vehicle makers, with few exceptions, have met their Canadian production-to-sales ratio requirements and value-added commitments.

Current Canadian concerns about the effect of the Auto Pact on Canada-U.S. trade in the automobile industry pertain, first, to the possibility that U.S. companies may import vehicles from Japan under joint-venture arrangements and then re-export them to Canada duty free (thus circumventing the duty payable in Canada on direct Japanese imports); secondly, that there may be developed in the United States Japanese vehicle plants which may be able to export vehicles into Canada duty free; and thirdly, that parts may be imported by U.S. firms from subsidiaries in low-wage countries such as Brazil and Mexico which could be employed free of duty in U.S. and Canadian assembly plants. Canadian plant suppliers argue that the absence of a North American content requirement applying to U.S.-based firms, equivalent to the local content requirements applying to Canadian-based firms, exacerbates these tendencies and accounts for a declining North American market share for Canadian parts suppliers.

CANADIAN AUTOMOTIVE TRADE OUTSIDE THE AUTO PACT

Almost all of Canada's automotive trade outside the Auto Pact is one-way trade in the form of Japanese and European imports. Canada's exports to Japan in 1982, at \$10.9 million constituted a mere 1 percent of Japanese imports at \$1.5 billion. Japanese imports increased their share of the Canadian market from 17.5 percent in 1978 to 31.3 percent in 1982. "Voluntary" export restraints (VERs) were negotiated between the United States, Canada and Japan in 1981 (Canada, 1983c, p. 35), which largely arrested these trends. In mid-1985, however, the restraints were removed and replaced by informal understandings with Japan about permissible limits on increases in market shares. The VER did not apply to other foreign-car manufacturers, and the South Korean "Pony" rapidly increased its market share during this period, aided by the absence of duties on imports from less-developed-countries (LDCs).

GOVERNMENT ADJUSTMENT PROGRAMS FOR THE AUTOMOTIVE INDUSTRY

The Automotive Adjustment Assistance Program

Under the Automotive Adjustment Assistance Program (AAA), which was introduced as a result of the Auto Pact, an Adjustment Assistance Board was established to administer the two parts of the AAA program:

loans for auto-parts manufacturers and transitional assistance benefits (TAB) for the auto workers. Vincent Bladen, who had served as Chairman of the Royal Commission on the Automobile Industry, was appointed Chairman of the Board. The AAA reflected the Canadian government's belief that despite the economic growth the Auto Pact would bring to the Canadian automotive industry, some firms would need assistance if they were adversely affected by the Pact, or if they were unable to take full advantage of the opportunities the Pact opened up to Canadian producers. These opportunities promised expanded production, rationalization of output, and reduced costs.

On this basis, the government made loans available to those producers of automotive products who had a reasonable prospect of maintaining profitable operations, but who, without such assistance, would be prevented from doing so through lack of financing. Loans were made available to firms manufacturing the automotive products covered by the Auto Pact (except for companies which manufactured automobiles or firms affiliated with automobile manufacturers) for the purpose of acquisition, construction, installation, modernization, development, conversion, or expansion of land, buildings, equipment, facilities or machinery, and for use as working capital. The loans were made at an annual interest rate of 6 percent and were repayable over periods of up to 20 years. A tariff-remission scheme was also made available for equipment not available in Canada within the time needed to meet production schedules (Matthews, 1971, pp. 102-103; Canada, 1985, Appendix B). When the funding programs were terminated in 1973, a total of \$83 million in low-interest loans had been disbursed (Canada, 1983, p. 31).

The Adjustment Assistance Board also administered the parallel program of auto-worker assistance, the Transitional Assistance Benefit Program (TAB). The objective of TAB was to provide income maintenance to workers who might be dislocated as a result of the industrial restructuring which occurred in conjunction with the 1965 Auto Pact. Effective until 1976, TAB applied to individuals laid off for at least four weeks and to layoffs of at least 50 employees or 10 percent of the work force in a plant, whichever was less. Unemployed workers would qualify for benefits if they had worked at least 16 weeks (initially the qualification period had been 30 weeks) in the automobile industry in the year prior to being laid off. One week of benefits accrued for every two weeks an individual had worked in the industry to a maximum of 52 weeks. Workers in training programs, however, could receive benefits for one and a half years. Assistance benefits ranged from 62 percent to 75 percent of the worker's pay, depending on the number of his or her dependents. In practice, the number of workers who actually received benefits was small. The total number of recipients was 3,100 for the entire program period (1965 to 1976). Another 735 workers had been disqualified from receipt of benefits because they were already receiving

supplemental unemployment benefits through private income-protection plans (OECD, 1984, p. 28). This relatively low participation rate probably can be explained by a combination of restrictive eligibility requirements and the fact that the employment-disruption effects of the Auto Pact were not as great as anticipated. The period during which TAB operated was one of relative economic buoyancy; workers were more likely then than today to find other jobs without experiencing protracted unemployment.

The Enterprise Development Program

Since the Automotive Adjustment Assistance Program (AAA) ended, the automotive industry has been assisted by a variety of general government programs to encourage new investment, to expand research and development, and to strengthen international marketing. Under the Enterprise Development Program (EDP) (1977–83), for example, financial support in the form of grants and loan assistance was available for high-risk and innovative projects or for adjustment projects designed to increase efficiency and competitiveness. The thrust of the program was to foster innovation in the design and development of new or improved products or processes and to assist in adjustment to changing economic circumstances (Canada, 1985, Appendix B; J.P. Johnson, 1982, pp. 29–34). The federal Department of Industry, Trade and Commerce had, as of early 1983, disbursed approximately \$105 million in direct grants and loans to the automotive industry under this and related programs. Of the \$105 million, \$40 million went to Ford Motor Company of Canada to secure the construction of a \$700-million engine plant in Windsor, \$30 million went to Deutz Diesel in Quebec for an extensive diesel-engine research and development program, and about 50 percent of the remaining \$35 million has gone to Canadian-owned parts-supply companies (Canada, 1983c, p. 31).

The Industry and Labour Adjustment Program

Since 1981, automotive companies and unemployed workers also have benefited from the Industry and Labour Adjustment Program (ILAP). As earlier noted, ILAP was designed to alleviate distress in designated communities caused by permanent large-scale industry dislocation in a given sector when such dislocation results in large layoffs which have a high impact on total community employment. The extent of the crisis in the automotive industry in 1982 led to an extension of ILAP to cover all automotive parts companies in Canada and not only those in the initially designated communities. As of 1982, four of the ten communities designated under the program were connected to the automotive industry: Windsor, Chatham, L'Islet/Montmagny, and Kitchener/Waterloo. Of the \$350-million budget of the four-year program, approximately \$35 million in assistance had been approved for independent parts manufacturers (J.P. Johnson, 1982, pp. 39–40; Canada, 1983c, p. 31).

Both EDP and ILAP (as of March 1984) have since been replaced by the Industrial and Regional Development Program (IRDP), which became effective in June 1983. IRDP is now the federal government's principal program for delivering direct assistance to private sector firms.

Other Programs

In addition to assistance given under the general programs listed, some assistance has been directed specifically at the automotive industry. The Duty Remission program, introduced in 1975 and expanded in 1978/79, aims at the promotion of sourcing of parts in Canada by firms outside the Auto Pact. The objectives of the Duty Remission program are: to increase exports, to increase Canadian value-added, to increase sourcing of parts production in Canada, and to bring about the establishment of non-American component plants by vehicle manufacturers in Canada. In addition, there exists the somewhat ad hoc and expensive practice of bidding against American state governments for capital investment by the larger motor-vehicle companies. The typical issue here is not whether or not to invest, but whether to invest in Canada or in the United States. Perhaps the most notable case of this nature was that involving Ford, the Canadian government, the Ontario government, and the state of Ohio. In this case, Ford induced the federal and Ontario governments to increase their support from \$30 million to \$75 million by pointing to the cost differential between expanding an existing plant in Ohio and building a new plant in Windsor. After extensive negotiations between the federal and Ontario governments, the federal government provided \$40 million and Ontario \$28 million in outright grants. In addition, \$28 million was expended in completing an expressway extension to the plant and \$7 million in municipal service costs. This assistance, it was claimed, would create 2,600 direct jobs and 100 or so feeder jobs. Ironically, within a few weeks of the Ford decision to build the plant in Canada, Budd Automotive Co. in Kitchener, Ontario lost a major Ford frame contract and announced its intention to lay off 1,000 workers, and Ford itself laid off for the winter 1,500 workers at another Windsor engine plant while it switched over production to a lighter engine (Witten, 1979).

CONCLUSIONS

Despite government policies toward the automobile industry. Canadians are faced with a growing parts deficit within the Auto Pact and a much more substantial deficit resulting from imports outside of the Auto Pact (APTA). A 1983 Federal Task Force, co-chaired by representatives of the parts industry and the United Auto Workers, on the Canadian Motor Vehicle and Automotive Parts Industry places much emphasis on the need for a new trade policy requiring all vehicle manufacturers who sell vehicles in the Canadian market to make binding commitments on

minimum Canadian content comparable to the commitments now being made by the vehicle manufacturers operating under the APTA. In addition to these minimum-content regulations, the Task Force called for programs directed at the technological development and expansion of the Canadian parts industry, and for an eventual general increase in all minimum levels of Canadian production shares; for a limitation of the preferential tariff rate extended to the developing countries for their automotive products to two-thirds of the most-favoured-nation (MFN) tariff rate for automotive goods; for a shift to the wholesale level and decrease of the federal sales tax; and for the expansion and extension of the ILAP program and the labour benefits it accords. The last recommendation obviously has not been followed, given the expiration of ILAP and its replacement by IRDP, although the manufacturer's sales tax for automotive products has been shifted to the wholesale level, effective March 1984.

The Task Force proposals — especially those pertaining to minimum-content requirements — have been trenchantly criticized by R.J. Wonnacott, who argues that taxpayers will forgo tariff revenues, consumers will pay higher prices, pressures for enhanced productivity and wage moderation will be reduced, retaliation from Japan, with which Canada presently runs a substantial trade surplus, may be precipitated, and the United States may view such proposals as undermining major premises of the Auto Pact (Wonnacott, 1984). These proposals, if adopted, may have many of the same consequences as similar policies have had for the Australian auto industry, which is one of the highest-cost, least efficient, auto industries in the world.

The voluntary import quotas negotiated with Japan in 1981 have helped to maintain domestic manufacturers' market share in the short run. On the other hand, these restrictions and the implicit restrictions which have now replaced them create a substantial cost to Canadian and American consumers of automobiles, perpetuate the deployment of assets in certain sectors when they might be deployed more efficiently elsewhere, and in themselves provide no assurance that restructuring and rationalization will take place to allow the North American industry to become self-sustaining, at least with respect to some product lines. Over the longer term, some contraction, greater automation to reduce labour costs, and greater specialization in product lines in special demand by North American consumers seem necessary if self-sustaining viability is to be achieved. Present policies appear designed to retard these adjustments.

It is striking that neither the relatively modest adjustment programs provided for under the Auto Pact nor the present import-restriction policies have been concerned primarily with facilitating adjustment by labour. Participation in the labour-adjustment programs of the AAP was trivial, while fairly substantial subsidies to firms were provided under

both the AAP and successor programs. The current voluntary import quotas, of course, have no labour-adjustment features and simply perpetuate the status quo. The combined impact of increased import penetration over the longer term and technological innovation that reduces labour intensity in domestic production suggests that this is a serious shortcoming. In other words, explicit firm subsidies under AAP, EDP and similar programs, and trade protection have completely overwhelmed labour-adjustment assistance. Adjustment has been retarded, and the major costs of adjustment have not been addressed. It must be acknowledged, however, that the ability of Canadian governments to reorient adjustment policies toward the automobile industry is severely circumscribed by American policies toward the industry, given the continental nature of the industry and the dominance of American ownership interests. Perhaps the situation may indicate that, as with the Auto Pact at an earlier date, the two national governments, admittedly focussing on different issues, should take some common action regarding positive adjustment strategies if they are to formulate constructive responses to the threat of loss of international competitiveness.

The Textile, Clothing and Footwear Industries

INTRODUCTION

Since the beginning of the industrial revolution in Britain, the textile and clothing industries have played a major role in the economic development of many countries. This is largely because, in their early stages, these industries tend to be highly labour intensive, to be easy to enter because of standardized technology, and to have readily accessible markets. These characteristics, however, have changed over time. In developed countries, including Canada, the textile industry has become a high-tech, capital-intensive industry. The clothing industry, by contrast, has tended to remain labour intensive because of its short production runs. In the latter industry, import competition stemming from low wages in developing countries has posed particularly acute problems for policy makers in developed countries. The market for textiles is threatened, in turn, by the dwindling market for clothing produced in developed countries, because of the dependency of textile industries in these countries on their domestic clothing industry as a market for their products.

Parallel developments to those in textiles and clothing have tended to occur in the leather and footwear industries. While leather industries in developed countries tend to be capital intensive and fairly competitive, the footwear industry continues to employ relatively standardized technology and remains labour intensive. The tanning industry suffers corre-

spondingly because of low-cost imports from developing countries, as the domestic footwear industry constitutes one of the tanning industry's few ready markets (Canada, 1981a, p. 7).

As a result of these developments, increased import competition became an acute threat to the industries of Canada and the other industrialized countries as early as the late 1950s. Although Article XIX of the General Agreement on Tariffs and Trade (GATT) and the negotiation of international and bilateral agreements restricting imports have allowed Canadian producers some protection against the inflow of imports, fundamental problems of adjustment still confront Canadian producers. Low-wage countries can produce, and will be able to produce for the foreseeable future, at far lower prices than can Canadian producers. In 1976, for example, Canada's wages in textiles and clothing stood at \$4.56/hr and \$4.40/hr respectively, while wages in Korea were \$0.44/hr and \$0.38/hr (ILO, 1977). Canada's economic choices, therefore, other than perpetual protection, appear to entail further efforts to improve productivity and hence competitiveness and/or gradual withdrawal from some segments of the industry.

THE ROLE OF THE TEXTILE, CLOTHING AND FOOTWEAR INDUSTRIES IN THE CANADIAN ECONOMY

Tables 2-7 and 2-8 indicate the trends in Canadian textile, clothing and footwear industries over the past 30 years. The value of shipments of textile, knitting, clothing and leather manufactures increased dramatically from 1955 to 1980, by 514 percent, 510 percent, 478 percent and 407 percent respectively; recently, however, increases in the value of these shipments have been relatively small. Employment grew until 1965 in the textile and leather industries and until 1975 in the clothing and knitting industries, but thereafter declined. From 1955 to 1982, employment declined in the textile, knitting, and leather industries by 14 percent, 15 percent and 25 percent respectively and increased slightly by 1.8 percent in the clothing industry. From 1955 to 1982, the number of establishments in the knitting, clothing and leather industries declined by 15 percent, 20 percent and 25 percent respectively, and the number of establishments in the textile industry increased slightly by 1.2 percent. The four-firm concentration ratio remained relatively high and constant in the textile industry and relatively low and constant in the knitting, clothing and leather industries between 1970 and 1980.

The Canadian textile, clothing and footwear (TCF) industries make a substantial contribution to the Canadian economy in terms of value-added and employment. In 1980, these industries contributed \$4.8 billion in value-added, or over 7 percent of the real output of the entire manufacturing sector in Canada. In 1982, TCF industries employed 206,000 people, or 11 percent of total manufacturing employment. This

TABLE 2-7 Trends in Canada's Textile, Clothing and Leather-Goods Industries

Industries	1955	1965	1975	1980	1982
Textiles					
No. employees	69,144	76,676	71,050	68,241	59,416
Value of shipments (\$'000)	734,515	1,276,657	2,439,005	4,423,248	4,507,573
No. establishments	977	960	923	948	989
Knitting Mills					
No. employees	21,658	24,070	24,682	21,220	18,318
Value of shipments (\$'000)	155,187	308,890	624,490	944,704	947,795
No. establishments	296	361	306	281	255
Clothing					
No. employees	89,686	98,659	100,528	96,120	91,306
Value of shipments (\$'000)	684,362	1,063,401	2,306,619	3,867,140	3,962,352
No. establishments	2,648	2,315	2,094	2,143	2,107
Leather products					
No. employees	30,575	32,585	26,834	24,922	22,957
Value of shipments (\$'000)	218,043	343,055	619,191	1,083,793	1,105,960
No. establishments	646	544	415	431	419

Source: Statistics Canada, *Industrial Organization and Concentration in the Manufacturing, Mining, and Logging Industries, 1980* (Ottawa: Minister of Supply and Services Canada, 1983), p. 9.

TABLE 2-8 Weighted Averages of Concentration in Canada's Textiles, Clothing and Leather-Goods Industries

Industries	Weighted Average CR4s ^a					
	1970	1972	1974	1976	1978	1980
Textiles	59.5	61.4	60.1	58.9	58.0	59.3
Knitting Mills	25.3	23.5	23.1	—	22.9	23.1
Clothing	14.5	14.4	—	—	16.0	—
Leather Products	33.2	33.7	—	35.1	37.1	—

Source: Canadian Industrial Renewal Board, "Brief to the Royal Commission on the Economic Union and Development Prospects for Canada" (Ottawa: October 1983), p. 2.

a. Concentration is measured by the leading four enterprises' share of industry shipments, weighted by value added of each industry.

employment figure is even more significant when viewed in terms of female employment, as TCF industries account for over one-third of all available female manufacturing jobs.⁸

The contribution of the TCF industries to natural resource upgrading, exports and technological spin-offs is less sizeable. With the exception of a major portion of Canadian furs, hides and some synthetic fibres, the majority of raw materials used in the manufacturing of clothing and other textile products such as raw wool, cotton, silk, acrylic fibres, are imported because it is either not economical or technically feasible to produce them in Canada. Exports from TCF industries have increased marginally over the last decade; in 1982, they amounted to \$760 million or 7.5 percent of TCF production. This represents slightly more than 1 percent of the \$59.9 billion worth of exports by Canada's total manufacturing sector in 1982 (which, in turn, amounted to one-third of total manufacturing production). It may be even more important, however, that imports of TCF products amounted to \$2.9 billion, resulting in a TCF trade deficit of \$2.2 billion in 1982 as compared to a total manufacturing surplus of \$4.4 billion (Canadian Industrial Renewal Board (CIRB), 1983a, p. 2).

The importance of the TCF industries to employment becomes even clearer when they are viewed in terms of regional distribution of employment in Canada. Of the 206,000 workers employed (11 percent of manufacturing and 2 percent of total employment), 54 percent are employed in Quebec and 36 percent in Ontario (CIRB, 1983a, p. 4). Within Quebec TCF activity provides for 4.5 percent of total and 21 percent of manufacturing employment (112,000 workers); 59 percent of these jobs are centred in Metropolitan Montreal, mainly in clothing (65 percent). In other areas such as the Montreal Plain, Eastern Townships, "Bois-Francs" and Mauricie, TCF employment is also significant, representing between 20 percent and 45 percent of manufacturing employment (*ibid.*, p. 5).

In Ontario the TCF industries' share of manufacturing employment is slightly less significant, with 74,000 TCF workers accounting for 8 per-

cent of manufacturing and 2 percent of total employment. Approximately 45 percent of these 74,000 employees are concentrated in Metro Toronto, but they account for only 10 percent of manufacturing employment there, compared to 23 percent of manufacturing employment in Metropolitan Montreal, accounted for by Montreal's 59 percent of the 112,000 Quebec TCF workers. Fifteen percent of TCF employment is located in eight eastern Ontario communities; these communities are considered to be dependent on TCF activity, which accounts for more than 20 percent of manufacturing employment in these areas. The remaining 40 percent of TCF jobs in Ontario are scattered through other Ontario communities (CIRB, 1983a, p. 5). The only other major TCF concentrations are in Metropolitan Winnipeg, which accounts for 36 percent of the remaining 20,000 TCF jobs in Canada, and Truro, Nova Scotia, which accounts for 6 percent of these jobs.

Partly because of the political implications of these regional employment factors, the Canadian government has intervened through the years to assist the TCF industries, especially with respect to import competition. The government has employed numerous policy approaches, including tariffs and other border measures, industrial incentive programs and, most recently, the 1981 Clothing and Textile policy.

GOVERNMENT POLICIES TOWARD THE TEXTILE AND CLOTHING INDUSTRIES

In 1976, Quebec accounted for 59 percent of employment in the textile and clothing industries, while Ontario accounted for 31 percent of employment in these industries. These percentages are even more significant when one takes into account the fact that more than 65 percent of clothing employment is in Quebec, and that for more than 20 Quebec communities, textile activities are their key industry (Canada, 1978b, p. 3). In terms of political salience, textile and/or apparel plants exist in 71 out of 75 federal constituencies or ridings in Quebec and in 86 out of 95 ridings in Ontario. Moreover, there are such plants in 230 of the 282 federal ridings that elect Members of Parliament (Barry, 1983). The kind of effective lobbying that such locational factors can bring about was well described in 1981, when Ian Stewart, President of the Stewart-Group Ltd., stated:

For years, the C.T.I. [Canadian Textiles Institute] had tended to lobby the "mandarins" or civil service, but we decided that we would get further if we got after our elected representatives. Commencing in January of 1981, the industry put on one of the best and most concentrated campaigns centered on the elected members of parliament, and almost every member of the cabinet was visited personally by an industry representative — usually the chairman or chief executive officer of a major company.

The result of all this effort was the announcement by Herb Gray, on June 19th, in which he indicated that the government was prepared to follow the recommendations of the Textile and Clothing Board, and grant us some form of protection throughout the 1980s. (Stewart, 1982, p. 42)

This announcement has since been reflected in the Canadian Industrial Renewal Program, the most comprehensive policy yet introduced with respect to adjustment problems in the textile and clothing industries.

Labour representation in the textile and clothing industry has long been plagued by institutional discord and fragmentation. Arguably, fragmentation in the industry mirrors the lack of cohesiveness which characterizes the larger Canadian union movement. In 1968, for instance, the seven unions in the textile and clothing sector were affiliated with three distinct union centrals. While four of the largest unions were affiliated with the Canadian Labour Congress (CLC), they "remained as divided, organizationally and ideologically, as they had been prior to the formation of the CLC" (Mahon, 1984, p. 34). Moreover, the international character of the various unions provided an additional obstacle to the development of a coherent, pan-industry, labour position.

The differing levels of organizational capacity evident in the clothing and textile industries are striking. In the former industry, representation is highly fragmented. In the 1950s and 1960s, there were no fewer than 12 trade organizations representing the industry. Most of the organizations were services oriented and were not concerned with influencing government policy. Despite repeated efforts by the federal government, the quality of representation remained low in the industry. However, the federal government's establishment of the Canadian Apparel Manufacturers Institute in 1976 enhanced the level of representation. As a consequence, the clothing industry contributed considerably to the formation of the 1981 policy. The quality of representation in the textile industry contrasts markedly with representation in the clothing industry. The role played by the Canadian Textile Institute (CTI) provides the textile industry with well-disciplined and cohesive leadership. The effectiveness of the CTI is largely attributable to the efforts of dominant firms in the industry. Although the CTI represents fewer than half the firms in the industry, its members produce over 80 percent of total output (Mahon, 1984, p. 35).

The CTI's role in advancing industry interests has been frequently buttressed by textile-labour representatives. Prior to the formation of the 1971 Textile Policy, for instance, both textile-industry and -labour representatives actively lobbied federal politicians. The industry deftly promoted its case by exploiting growing government concern over labour militancy and Quebec nationalism. As a result of its labour intensity and geographic concentration in Quebec, it was in a particularly advantageous position to play on political vulnerabilities of the federal government. Further, by 1969, the CTI claim for a new textile

policy received the support of both the Quebec and Ontario governments. Impelled by the fear of a large-scale flight of capital from Montreal to Toronto, the federal government responded in February 1969, by authorizing the Department of Industry, Trade and Commerce to review the industry's needs with an eye to developing a long-range policy.

Responsibility for the formulation of textile and clothing policy is dispersed across a range of government agencies and departments. While some of these governmental interests have mandates which span large domains and affect a multiplicity of industries and regions, the purview of other governmental interests is confined exclusively to the textiles and clothing industry. Examples of the former can be found in the Department of Finance, the Ministry of State for Economic Development (until its abolition) and the Tariff Board. Because of the broad diversity of interests and issues that are affected by their mandate and the considerable in-house research capabilities of each, the development of a clientele relationship with industry was contained. Consequently, claims for assistance by industry were scrutinized closely by these actors and often resisted strenuously.

In contrast, those agencies whose purview is confined to the industry have tended to give evidence of close and arguably incestuous relationships with industry. Both the Apparel and Textile Branch of the Department of Industry, Trade and Commerce and the Textile and Clothing Board have been accused of possessing a strong pro-industry bias. Critics of both agencies charge that neither has the capability or the willingness to evolve a clear view of the industry's needs, distinct from that advanced by the industry itself (Mahon, 1984, p. 78; Protheroe, 1980, p. 61).

Whatever the reasons for seeking to preserve Canada's textile and clothing industries, some form of protection of these industries has existed since the National Policy of 1879. The tariff structure proved sufficient protection for the first half of the 20th century as the two World Wars stimulated new, but product-specific, growth in the industry. The postwar period also saw the launching of a vigorous program of modernization and diversification which resulted in both new jobs and production until the beginning of the 1950s. Clothing and primary textiles were the sectors which benefited most from this growth, while the knitted goods sector grew at a slower pace (Canada, 1978b, p. 1). While Canada remained a major importer of textiles from the industrialized countries throughout this period of growth, the 1950s saw the Canadian textile industry deteriorate because of a sharp increase in imports from low-wage countries, especially from Japan. To alleviate the situation, the Canadian government augmented the already heavy tariff protection by a series of "voluntary restraint programs" with Japan and several other low-wage countries. These restrictions, which were introduced in 1956,

were formalized in 1960 and further refined in 1962 (Thur, 1982, p. 17). Table 2-9 gives some indication of the nominal and effective tariffs on imports and the proportion of imports not subject to tariffs for textiles, knitting, and clothing for the years 1970, 1975 and 1978 or 1979.

The Canadian domestic textile industry's market share of domestic consumption fell from 70 percent in 1949 to 60 percent in 1959, by which time Japan and other Asian producers accounted for 20 percent of Canada's cotton-textile imports. Although domestic clothing suppliers continued to retain almost three-quarters of the home market until the 1970s, Japanese and Asian imports accounted for 72 percent of Canada's clothing imports by the end of 1959 (Mahon and Mytelka, 1983, p. 563). Industry concerns about rising imports led the Canadian government to support, first, the Short Term Agreement (STA) in 1961 and then, in 1962, the Long Term Agreement on Cotton Textiles (LTA), which regulated international trade in textiles from 1961 to 1973. The effect of these arrangements, which were limited to cotton products, was to permit importing countries to negotiate with specific exporting countries "bilateral agreements" within the GATT rules, to limit trade in textiles and apparel. The agreements dealt with the levels of imports that could be restrained and provided for automatic annual increases in the levels of restraint (Thur, 1982, p. 18). Beginning January 1, 1974, the LTA was replaced by the Multi-fibre Arrangement 1 (MFA 1), which was extended to include textiles and clothing made from wool and synthetic fibres. The MFA 1 also had relatively liberal provisions for annual growth (6 percent) in levels of imports, for switching import categories, and for carry-over and carry-forward, all provisions which permitted exporters, during the restraint periods, to ship quantities of textiles and clothing in excess of basic levels.

Even before MFA 1, Canada had negotiated restrictions on textiles and clothing imports other than cotton. Until 1976, however, Canada followed a selective approach to special measures of protection against injurious imports by initiating action only when serious injury was found to have been caused or threatened. But this product-by-product, country-by-country approach increased the number of negotiations, especially as agreements were only for one year's duration. Because of the complexities involved in such a process and the generous growth rate for imports and flexible provisions in the MFA 1, imports continued to grow at a rapid pace after 1974. While the proportion of the value of Canadian imports of textiles and clothing from low-wage countries rose only from 20 percent to 29 percent from 1966 to 1975, there existed significant differences in the growth of imports within the grouping. The proportion of imports of fibres, yarns and fabrics from low-wage countries dropped sharply, while the proportion in the clothing sector rose dramatically from 29 percent to 61 percent (Canada, 1978b, p. 24). The injury caused by such a surge of imports was so sudden and serious that

TABLE 2-9 Goods Subject and Not Subject to Tariffs

	Nominal Tariffs (%)			Effective Tariffs (%)			Proportion of Imports Not Subject to Tariffs (%)		
	1970	1975	1978	1970	1975	1978	1970	1975	1978
Manufactures									
Textiles	14.2	14.2	12.5	17.9	20.3	18.7	9.9	7.4	13.3
Knitted goods	27.6	24.1	22.9	43.0	34.5	35.0	—	0.1	8.0
Clothing	21.6	21.9	20.3	25.0	28.2	25.7	0.2	1.3	6.6

Source: J.R. Baldwin and P.K. Gorecki, "Canada-United States Productivity Differences in the Manufacturing Sector: 1970, 1979" (Ottawa, August 1984), p. 57, mimeo.

the government, on the recommendation of the Textile and Clothing Board, invoked Article XIX of the GATT, and on November 29, 1976, a global quota system was imposed on virtually all clothing imports and on all countries of origin, developing, industrialized or socialist. The level of quotas approximated 90 percent of the volume of actual imports in 1975. This global system remained in place until the end of 1978 and is claimed to have restored about 15,000 jobs to domestic manufacturing. But the cost to clothing and textile importers was high: about 1,000 of them went out of business causing a significant offsetting loss of jobs (Merchant, 1981, p. 8).

Surges in imports such as Canada experienced in 1976, when imports were growing at a rate approaching 50 percent as compared to 1975, were largely the result of the basic MFA principles themselves (Thur, 1982, p. 20). The MFA has never provided for cut-backs in quotas, and actual entitlements of exporting countries were strictly based on their actual exports in the year preceding negotiations. Hence, exporting countries had an incentive to maximize their future entitlements by maximizing their actual exports during 1976, the year preceding the renegotiations which were to take place over MFA 2.

The 1977 renewal of the MFA reproduced the main stipulations and conditions of MFA 1, but also introduced a major change by recognizing the possibility, in special cases, of "reasonable departures" from its particular stipulations. In essence, these reasonable departures were a recognition of the need for protection of sensitive products; they meant that if adherence to the general stipulations of the MFA 2 could present a serious injury or threat to a particular sector of the industry, the participant importing and exporting countries could agree in their bilateral restraint agreements on growth rates and flexibility provisions below those stipulated in the MFA 2 (Thur, 1983, p. 51).

The MFA 3 was adopted officially on December 22, 1981 (expiring in 1986); it is much more restrictive on imports than its two predecessors. It contains virtually no base guarantees of import levels, and it allows the application of nominal growth rates only and of an "antisurge" mechanism to limit actual growth of imports of a product to a jointly-agreed percentage over the previous year. As of August 1983, Canada had 19 bilateral arrangements with countries such as South Korea, Hong Kong, Taiwan and China. Most of these arrangements, however, were negotiated before the adoption of MFA 3 and do not include many of the protective features which MFA 3 permits. The countries involved in these agreements are largely the "low-cost" countries or the "State-trading" countries like those in Eastern Europe. During the 1960s and early 1970s, these arrangements mainly covered textiles, but since 1977 they have applied mainly to clothing. In 1982, only 5.6 percent of Canada's imports of textiles were covered by these bilateral arrangements, in contrast to 76 percent of all clothing imports. Adding the two

together, the coverage for textiles and textile products stands at 22 percent; the remaining imports are covered by the regular tariff. The American level of protection under bilateral agreements, by contrast, stood at 86 percent in 1982 (Barry, 1983, p. 21). It is possible, however, that these import restrictions would have a smaller impact on the price and variety of such goods available in the United States than they would in Canada because of the relatively larger U.S. market and greater internal competition.

To this point the discussion has focussed on general international trade policies which have served mainly to protect domestic manufacturers from competition rather than to encourage them to adjust to the changing international environment. In May 1970, however, the Canadian government defined and announced Canada's first Textile Policy, in response to a joint submission by the Canadian Textile Institute and the unions to the federal cabinet in the fall of 1968, requesting a "new national policy for clothing (Mahon and Mytelka, 1983, p. 564). The aims of the Canadian Textile Policy were "to provide a sense of direction, a framework and conditions within which the textile and clothing industries can plan, invest and develop with a greater degree of confidence" and "to create conditions in which the Canadian textile and clothing industries continue to move progressively towards viable lines of production on an increasingly competitive basis internationally" (Pestieau, 1976, p. 13). As Caroline Pestieau points out, three central premises were reflected in the government's announcement of the establishment of the Canadian Textile Policy: that the Canadian textile industry was not going to be allowed to disappear in Canada; that with suitable encouragement it could ultimately become viable; and that the machinery which the government planned to set up would be flexible enough to sustain viable product lines while retaining for Canadians the advantages of a traditionally open market. "Viable" here was to be interpreted restrictively, however, meaning that in the long run, import controls could be lifted, and that domestic goods could compete with foreign goods in the home market, protected only by the tariff. Industry officials tended to view even this restrictive viability as utopian as long as they faced competition from textile suppliers in low-cost areas. They saw future viability only with respect to competing with developed countries (*ibid.*, p. 14).

The key component of the new textile policy was the Textile and Clothing Board, which was empowered to conduct inquiries to determine whether imports from low-wage sources were causing, or threatening to cause, serious injury. In so doing, it was to receive submissions from importers, users and final consumers, as well as from domestic producers. In bringing complaints before the Board, domestic producers were required to file their adjustment plans, offering proof of their intention to restructure if temporary protection should be recommended. If the Board finds that imports are threatening injuries, it can recommend to the Ministry of Industry, Trade and Commerce that

special measures of protection be invoked. There are five factors which the Board considers in making these recommendations:

1. relevant manpower and regional employment considerations;
2. Canadian obligations under international trade agreements;
3. the probable effect on users and final consumers of protection of the product in question;
4. prevailing conditions of international trade in textiles and clothing including the likelihood of any changes in these conditions; and
5. the viability principle: "that special measures of protection are not to be implemented for the purpose of encouraging the maintenance of lines of production that have no prospects of becoming competitive with foreign goods in the market in Canada if the only protection provided is that provided at any time by rates of duties or customs" (Pestieau, 1976, p. 20).

The two factors on which the TCB relies most in defining injury are sudden surges in imports and falling prices of goods offered by low-cost exporters. Other considerations include slow-downs in domestic production (that is decreased shipments and capacity utilization and increased inventories), layoffs, reduced work hours, low profits and decreasing or zero growth.

The Board, despite the hopes of many textile manufacturers, has refrained from defining "injury" in terms of the erosion of the domestic producers' share of the Canadian market and has thus refrained from identifying a particular figure as the minimum share of the market for domestic firms. For example, clothing and textile imports accounted for 24 percent of the domestic market in 1976 as compared to 16 percent in 1965. If calculated in terms of fibre-weight equivalents, the degree of import penetration has been considerably greater, with imports of cotton, wool, yarns, synthetic fibres and filaments increasing from 36 percent of the domestic market in 1964 to 60 percent in 1976 (Canada, 1978b, p. 26). These market-share figures underestimate the effect of imports because of the multiple counting of dollar shipments to arrive at a measure of Canadian market size, and because imports are valued f.o.b. Conversely, the fibre-weight equivalent calculations overestimate the degree of import penetration because they do not take into account the value-added and employment in Canada facilitated by the importation of fibres, yarns and fabrics. By 1980, Canada was importing \$1.6 billion worth of textiles which constituted about 26.4 percent of the apparent domestic clothing market demand for textiles. In 1979, per capita imports of combined textiles and clothing from all countries were higher in Canada than in the United States, Japan or the European Community ("Sound and Balanced Decision," 1981, p. 12).

The Canadian Textile Policy involved objectives other than providing temporary measures of protection against imports in viable lines of production; in particular, it was to assist Canadian manufacturers and their workers in meeting the problems of changing trading conditions through the provision of adjustment assistance and programs to improve productivity and marketing capability (industrial incentive programs), as well as to promote exports. One of the purposes of adjustment-assistance programs is to compensate those injured as a result of government trade-policy decisions and to aid them in redirecting their resources and energies into more productive fields. For textile and clothing employees, however, the thrust of the Adjustment Assistance Benefits (AAB) Program, which was introduced as part of the Canadian Textile Policy, was compensatory as opposed to adaptive. When workers who had been permanently laid off requested it, the Textile and Clothing Board examined whether the dislocation was attributable to one of three factors:

- tariff reductions on textile and clothing items;
- conditions for special protection set by the government; or
- serious injury or threat thereof in a case in which the government decided not to impose special measures of protection.

This provision of assistance as compensation for not restraining imports was an important policy development, as it established that protection and adjustment assistance could be alternative responses to the same problem (Pestieau, 1976, p. 38).

The AAB Program provided pre-retirement benefits to laid-off workers between the ages of 54 and 65 as last-resort income maintenance for those workers unable to find employment at comparable wages. To be eligible, workers had to have been employed for 10 of the previous 15 years in either the textile or clothing industries and had to have worked 1,000 hours in each of those 10 years. Benefits were calculated, like unemployment insurance benefits, at two-thirds of average weekly earnings in the 20-week period prior to layoff and were only payable after regular unemployment-insurance benefits had expired. The AAB Program also made available supplementary unemployment-insurance benefits to workers under the age of 54, raising benefits from 50 percent of insurable earnings to two-thirds of earnings. More than 2,000 workers received these supplementary benefits in 1971 and early 1972, before they were discontinued when regular unemployment-insurance benefits were raised to this level. Both forms of benefits applied only to certified layoffs, that is layoffs of either 50 employees or 10 percent of a firm's work force, whichever was less, lasting a minimum of four months. In order to prevent older workers from opting for early retirement when they might have productive years of employment remaining, eligibility was granted only to those determined to be incapable of being placed,

retrained or relocated, or to those who had accepted employment at a wage less than their previous average insurable earnings (OECD, 1984, p. 30).

Program use was limited: as of 1976, all claimants came from the primary textile sector, and only 4 percent of those certified as eligible to apply actually received benefits (Pestieau, 1976, p. 38). Another source put the total approved claimants, up to 1980, for all of clothing, textile, footwear and tanning industries at 900 (OECD, 1984, p. 30), a figure which is also minimal, given the overall employment decline in those industries. This figure compares to the estimated total of 600 claiming workers in 1977, when more than \$4.5 million had been paid out (Canada, 1978b, p. 35). Perhaps even more important for adjustment purposes, however, is that the Textile Policy did not develop new measures aimed at increasing worker mobility or at making it financially rewarding for people to move out of textile production. In the clothing sector, especially, a large proportion of workers are women with commitments to families, most workers are unskilled or semi-skilled, many are over 50 years of age, and many face language barriers. Despite the low skills and immobility of many textile and clothing workers, limited funding has been allocated to employment training and redeployment. The latter aim has remained the responsibility of the Canada Employment and Immigration Commission's (CEIC) job placement, staffing, employee-mobility, consultative and training services. In the 1972–76 period, the CEIC spent approximately \$10.2 million in support of on-the-job training in the textile industry and paid approximately \$8.2 million to textile workers to return to vocational training institutions (*ibid.*). The Quebec Department of Manpower and Immigration also shares with the federal government and the textile industry the cost of on-the-job training for fashion-design students. In addition, the Ontario government's Employment Development Fund (EDF), through the Ontario Textile Assistance Program, granted \$368,420 to 6 Ontario textile and apparel firms in 1981. It was hoped that the grants would encourage more than \$2.5 million worth of capital expansions and would help the companies to stabilize 862 jobs and to create 50 new jobs by 1986 ("Employment Development Fund," 1981).

Downside labour-adjustment processes in the textile and clothing industries have recently been analyzed in a study conducted by Graham Glenday and Glenn Jenkins, which examines the histories of 4,250 workers who lost their jobs in the clothing, knitting, textile and electrical product sectors because of import competition during the years from 1974 to 1976 (Glenday and Jenkins, 1981, pp. 29–30). Their results showed mean duration of unemployment to be 12.5 months and median duration to be 7.3 months; subsequent employment spells averaged 16.1 months, and workers were employed 55.5 percent of the time. These figures, however, conceal the disparities between age, skill and sex groups. Prime-aged males were unemployed for a mean of 5.4

months, older males for a mean of 12 to 13 months, and females, especially those with spouses, for an even longer period of time. Low education and skills also were factors in making it difficult to regain employment, and Quebec workers generally had more difficulty in finding and keeping work than did their Ontario counterparts. Wage losses also varied, with losses for those moving to higher-paying jobs limited to \$2,000, while losses to those moving to lower-paying jobs — most of whom were women and relatively more highly skilled workers, who therefore had more to lose — were closer to \$10,000 (*ibid.*, p. 30). The authors concluded that it is desirable to give these workers compensation combined with re-employment assistance (which will, in turn, decrease necessary compensation) in order to minimize the private losses inherent in adjustment. Their reasons were that the extent of losses appeared small enough to be satisfied by lump-sum compensation payments, that these payments would compensate for the expenditure declines that occur in a region following plant closures, and that they would avoid the additional costs imposed on a worker when uncertainty exists about her/his future income stream.

Although this study usefully focusses on adaptive, as well as compensatory, approaches to worker-adjustment policies, the statistical results obtained must be viewed with some reservations. Though these results may well be indicative of the trends present in the labour market in terms of age, skills and gender, it must be noted that the period immediately following this 1964–75 layoff period was one in which the Canadian government had invoked global import quotas on clothing with the consequences, already noted, of a restoration, by 1978, of 15,000 jobs in the clothing sector and probably a somewhat smaller number of jobs in the textiles sector.

Adjustment assistance to primary textile and clothing firms under the Textile Policy was made available under the General Adjustment Assistance Program (GAAP) sponsored by the Department of Industry, Trade and Commerce. The assistance was available in the form of government insurance for loans made by commercial lenders, of direct government loans, and of grants covering up to 50 percent of the cost of consulting services required to develop adjustment proposals. When the GAAP eligibility conditions were changed somewhat in January 1971, in order to accommodate textile and footwear manufacturers, some manufacturers also were able to obtain direct loans for adapting efficiently to injurious import competition, and others were able to obtain government insurance of private loans in order to restructure to meet the competition in either the domestic or the export market if they submitted comprehensive restructuring plans. In the GAAP, too, participation rates have been low. Consultancy grants have been few and modest; only \$84,000 out of a total of \$370,000 went to textile and consumer products from 1970 to March 1974 (Pestieau, 1976, p. 40). By 1983, only nine textile companies

had used the loan-guarantee and consultancy-grant program, and only one of these was judged by Mahon and Mytelka to be a dynamic efficient enterprise. While more clothing firms utilized the programs — 37 received insured loans and 112 received consultancy grants — these firms represented only a small part of the 1,500-firm industry (Mahon and Mytelka, 1983, p. 567).

Funding has also been provided for the establishment of productivity and development centres for textiles and clothing in Winnipeg (where centres are already established), Montreal and Toronto (where their establishment is in process). These centres are viewed as essential to the adjustment of smaller firms because they sponsor seminars for managerial and supervisory personnel, provide advice on new production techniques, and fund the purchase of expensive equipment such as computerized pattern graders and marker makers, which can be used by small firms on a fee-for-service basis (Mahon and Mytelka, 1983, p. 568). Export promotion was also an integral part of the Textile Policy because policy makers believed that specialization for export was one of the ways Canadian industry could rationalize its production. Since the introduction of the policy, three export-oriented programs have been established: the Fashion Design Assistance Program (FDAP), the Program for Export Market Development (PEMD), and the Promotional Project Program (PPP) (Canada, 1978b, p. 35).

In terms of existing programs complementary to the Textile Policy, use has been made primarily of the Program to Enhance Productivity (PEP) and DREE. PEP provides up to 50 percent of the cost of feasibility studies on selected projects involving a significant departure from a company's normal productivity-improvement practices, and Canadian apparel firms have found it of help in undertaking studies on improving schedule techniques, cutting and sewing devices for time saving, and for reduction of material wastage. Estimates on the implementation of these studies show output per person/hour increasing from 10 percent to 15 percent (Pestieau, 1976, p. 42). Although over half of the assistance of the programs under PEP has gone to the textile and clothing industries, the recipients of this assistance represent only 5 percent of clothing manufacturers. DREE, in turn, was attractive to textile firms in designated areas of slow growth because it could provide funding in excess of most PEP grants. DREE provided funding for up to one-fifth of approved capital costs arising from modernization or expansion and for up to one-fourth of investment in new facilities or new product expansion, plus \$5,000 per new job created (*ibid.*, p. 43). From its creation in 1968 to the end of 1976, DREE had awarded to the textile industry more than \$52 million in investment grants, which are claimed to have created or maintained some 22,548 jobs (Canada, 1978b, p. 35).

The effects of the Textile Policy of 1970 appear to have been rather limited. Because the Textile and Clothing Board (TCB) focussed on

inquiries and recommendations addressed to very detailed product lines, its investigative efforts were diffused over too many issues of limited scope. Similarly, the financial means to implement the policy were spread too widely and too thinly to achieve major structural changes. Firms that wish to depart radically from their normal productivity-improvement practices or from traditional product lines still have to rely on existing programs such as PEP and DREE. A problem with both these programs, however, is that neither is closely integrated with the Textile Policy, and it is therefore possible that they may offer a grant to an applicant who is investing in a line of production which the TCB judges to be doubtful in terms of long-term viability or already in sufficient supply. Obviously, the Textile Policy cannot improve the competitiveness of the textile and clothing industries if policy makers continue to tackle the problem by looking separately at literally hundreds of individual products. Progress by way of small scattered improvements does not add up to significant steps forward in the competitive capacity of two large industries like clothing and textiles. The government seemed to recognize the need for additional concentration of focus and supplementary funding in its Policy for the Textile and Clothing sectors announced on June 19, 1981. Leaving the determination of injury from imports and the invoking of protective restraints to the Textile and Clothing Board, the new policy established the Canadian Industrial Renewal Board (CIRB) to provide a "one-stop" service for those firms in the textile and clothing industries which require assistance for modernization and restructuring. A further allocation of \$17 million to the CIRB also assigned a similar role to that board with respect to the footwear and tanning industries. It is therefore useful to trace the recent history of the footwear and tanning industries before we review the activities of the CIRB.

GOVERNMENT POLICIES TOWARD THE FOOTWEAR AND TANNING INDUSTRIES

The salient features of the Canadian footwear and tanning industries as they relate to adjustment problems are not unlike those of the clothing and textiles industries; the incidence of any shifts in trade patterns or policies is likely to fall on concentrated areas of the Canadian economy, especially given that in 1970, 103 of the 189 footwear factories were located in Quebec and another 74 in Ontario (Shoe Manufacturers, 1970, p. 3). Moreover, as the textile industry depends on the clothing industry, the tanning industry depends heavily on the footwear industry for markets. Indeed, 70 percent of its output goes to produce footwear, and 80 percent of the hides it processes are bovine hide, a material suited for the production of leather for footwear, but not for leathers for gloves, garments and upholstery (CIRB, 1983a, p. 3).

In terms of their contribution to the Canadian economy, the two industries provided 21,300 jobs in 1983; 2,300 of those jobs were in tanning and 19,000 in footwear (CIRB, 1983a, pp. 3–4). This combined figure totals fewer than the jobs provided by footwear alone in 1966 (25,360) and more recently in 1970 (22,000) (Shoe Manufacturers, 1970, p. 7). Despite the decrease in its employment level, however, the footwear industry, as a labour-intensive industry, remains an important employment provider in Canada, especially for low-skilled workers. Of the \$265 million total value of footwear shipments in 1968, approximately \$90 million was paid out for labour and \$125 million for materials and supplies (*ibid.*, p. 6).

It is because of this contribution to employment in concentrated geographic regions that the decreasing market share of Canadian producers has assumed importance to Canadian policy makers. Between 1956 and 1969, despite an increase of 5,300,000 in Canada's population, Canadian footwear production decreased by 810,000 pairs, or 1 percent, while imports of footwear increased by 39,200,000 pairs, or 568 percent (Shoe Manufacturers, 1970, p. 3). Per capita consumption of Canadian footwear decreased from 3.6 pairs to 2.6 pairs in the same period, while that of imported footwear increased from .5 pairs to 2.2 pairs (*ibid.*, p. 5). The domestic market share of Canadian footwear producers dropped from 58.7 percent in 1968 to 55 percent in 1969, to 42.6 percent in 1977 (*ibid.*; "Shoe Quota," 1980). Even though the Canadian market share increased by 4.7 percent in 1979, after the imposition of quotas in 1977, it had fallen back to previous levels by 1980 (*ibid.*).

In 1968, the largest share of the 45.2 percent of the domestic market came from the Asiatic countries (66 percent), Western European countries (21 percent), and Eastern European state trading monopolies (11 percent) (Shoe Manufacturers, 1970, p. 7). Not surprisingly, most low-wage countries are experiencing balance-of-trade surpluses on footwear, while high-wage industrialized countries are experiencing deficits.

Beginning with the 1974 sector strategy, the aim of the Footwear and Tanning Industries Adjustment Program (FTIAP) has been to make the Canadian industry competitive with imported products. The objective of the 1974 Sector Strategy was to provide financial assistance to the industry under programs such as the FTIAP, the establishment of a Development and Productivity Centre, Adjustment Assistance Benefits Program for displaced workers, Export Promotion Assistance, and improved market analysis and information, as well as the provision of grants of up to 80 percent of the consultancy costs for the preparation of restructuring plans. The strategy also provided direct loans for mergers and the acquisition of new equipment.

Unlike the situation in the textile and clothing industries, there are no formal mechanisms for establishing bilateral import-restraint arrangements. Instead, Canada has used global quotas on all or on certain

footwear imports. The quota system of 1977–80, which was later extended, was designed to limit overall imports to a maximum of 32.5 million pairs of footwear a year, about 80 percent of imports in the base period. The quota's restrictive effects were enhanced by the fact that the quota was not transferable between importers or between types of footwear. In 1981, the Anti-Dumping Tribunal reported that imports in at least some classes of footwear (women's and girls' shoes and sandals) had been restrained, but that there had been a rapid rise in the imports of ex-quota canvas-top dress and casual shoes because of the cheapness of canvas compared to leather and its increased fashion appeal. Although the Tribunal was unable to determine how much of the increase in footwear prices since 1977 had been the result of quotas, it did conclude that the quotas had contributed to this increase because of importers' tendencies to import higher-valued merchandise (Canada, 1981a, pp. 98–99). The Shoe Manufacturers Association challenges this conclusion, however, attributing the increased costs of footwear to a decline in the value of the dollar and the increased costs of petro-chemicals, especially oil, a claim supported partly by the Tribunal's findings (*ibid.*, p. 106).

The FTIAP program was initially administered (as was the textile and clothing policy) by the GAAP Board, which held this responsibility from 1977 to 1981. In addition to GAAP, the Enterprise Development Program (EDP) offered financial support in the form of grants and loan assistance that were available for high-risk and innovative projects, as well as for adjustment projects that could be expected to yield attractive rates of return on the total investment and/or provide economic benefit to Canada through an increase in, or sustaining of, exports and/or employment. The emphasis of the EDP was on product or process innovation and operational adjustment, and the focus was on increasing the viability of small and medium businesses, thereby improving their international competitiveness (Canada, 1985, Appendix B).

Adjustment assistance for labour is available under the AAB program, and assistance for industry is now available under the adjustment-assistance arm of the EDP, the successor to GAAP. Under the latter program, loans and loan insurance are available to manufacturing and processing firms that have been injured by import competition, to enable them to undertake activities to restructure their operations. Financial assistance for restructuring under the EDP included funds for the modernization of production facilities, the acquisition of additional working capital, or the sale of selected facilities (J.P. Johnson, 1982, pp. 33–34). To complement these financial programs, a Footwear and Leather Institute of Canada was established; it makes available to companies in the footwear and tanning industries specialized advisory services relating to productivity improvements, marketing, personnel and financial management. Concerning the actual amount of restructuring, the Anti-Dumping Tribunal reported in 1981 that while significant plant modernization and

enhanced management and labour productivity had occurred, there was no evidence of any fundamental rationalization such as fewer and larger firms, higher average employment, and larger scale of production. Instead, there had been no dramatic decline in the number of firms, and the industry remained about the same size. The Tribunal attributed this lack of change to the replacement of outgoing small firms by new ones, because of the lack of barriers to entry and the high risks involved in restructuring without a clearer indication of long-term government intentions relating to policies toward imports.

These programs were all revised as of November 24, 1981, when the government announced a \$17 million financial assistance program to be administered, alongside the textile and clothing program, by the Canadian Industrial Renewal Board and a three-year quota of \$34.1 million on all imports of non-leather footwear, including canvas, for the period December 1, 1981, to November 30, 1984. The quota was narrower in scope than those in place from December 1, 1977, to November 30, 1981, which were quotas on most types of footwear. Following a substantial increase in imports of leather footwear, the quotas were extended to other types in July 1982. Adjustment objectives involving the restructuring and rationalization of the domestic footwear and tanning industries are assisted through CIRB's Sector Firms Program; the community-diversification objectives are assisted through the CIRB's Business and Industrial Development Program, and worker assistance is proffered through the CEIC's programs.

CANADIAN INDUSTRIAL RENEWAL PROGRAM

The main objective of the 1981 Policy for the Textile and Clothing Sector, implemented through the Canadian Industrial Renewal Program (CIRP), is to assist the domestic clothing and textile industries to restructure, consolidate and modernize. The program has allocated \$250 million of assistance (\$267 million if the footwear and tanning industries are included) over five years to communities and workers affected by competition in these industries. Assistance is implemented through the Canadian Industrial Renewal Board (CIRB), which administers the new Sector Business and Industrial Development Program. This program provides assistance in establishing new employment opportunities in those communities heavily affected by industrial adjustment and sponsors the Labour Adjustment Program, a worker-assistance program administered by CEIC which helps workers to take advantage of new employment opportunities (Canada, 1985, Appendix B).

SECTOR FIRMS PROGRAM

The Sector Firms Program is aimed at making potentially viable textile, clothing and footwear companies more competitive with foreign com-

panies by helping them to restructure and modernize. The Board accordingly has developed three main criteria to guide its decision making:

1. The selection of the most competitive firms for assistance is seen as the best means of strengthening the overall competitiveness of each sector. The criteria for assessment of a firm's strength have been based on financial and management performance indicators and on the future plans of applicants.
2. Assistance is provided on the basis of a 3-to-5-year business plan touching upon all identified key weaknesses and strengths of the company.
3. Support is only given to firms which are committed to restructuring (the test being an undertaking by the firms to leave at least 75% of their after-tax profits in the company during a "control period" lasting 3 to 5 years) (CIRB, 1983a, p. 7).

This selective approach reflects a shift in government programs from the past focus on assistance based on need to assistance based on the potential of a given firm, and from focus on single-investment projects to general long-term planning. The third criterion is intended to ensure that public funds remain in the activity in question, and that unless market conditions change radically, most firms which agree to commit themselves to their plans will carry them out substantially as presented.

The CIRB contributed a total of \$104.6 million to 315 firms in the textile, clothing, footwear and tanning industries between November 2, 1981, and October 31, 1983. This figure represents commitments by the CIRB to investments of more than \$450 million by participating companies ("Restructuring of Textiles," 1984). By province, the distribution of funds committed as of August 31, 1983, was \$51.0 million to Quebec, \$29.9 million to Ontario, \$5.7 million to Manitoba, and \$1.9 million to other provinces.

BUSINESS AND INDUSTRIAL DEVELOPMENT PROGRAM

Complementing the Sector Firms Program has been the Business and Industrial Development Program, which is aimed at consolidating and diversifying the economic base of areas and communities heavily dependent on textile, clothing and footwear (TCF) activity. The Board, relying on an extensive review of communities where TCF activity represents at least 20 percent of manufacturing employment and 5 percent of total employment, has assessed the vulnerability and development potential of these areas and designated, for a two-year period, seven Special Areas that have priority in benefiting from the Business and Industrial Development Program. These areas included Trois-Rivières, Cap-de-la-Madeleine, Grand-Mère and Shawinigan, Drummondville, Victoriaville, Princeville and Plessisville, Sherbrooke and Magog, Valleyfield, Cornwall and Hawkesbury (CIRB, 1983b). The program is under the joint administration of DRIE and the CIRB, and it is aimed at

firms engaged in manufacturing, processing or specific business activities that are located in one of the seven Special Areas, or that are willing to set up there. Emphasis is placed in the selection process on accelerating the strengthening of linkages in the local economy and promoting activities and new businesses which are compatible with, and complementary to, the economic base of the areas.

In terms of actual assistance, between April 1982 and October 1983, the Board approved commitments of \$37.2 million ("Restructuring of Textiles," 1984) on 153 projects, representing investments of \$121.4 million, which were claimed to create or preserve 2,165 jobs (CIRB, 1983a, p. 9). Most of the assistance so far has benefited small and medium-sized businesses already established in the Special Areas which have embarked on projects of modernization, expansion, innovation, productivity improvements and maintenance. Only five outside companies which might promote diversification had been attracted to the Special Areas as of October 1983. Two of these, TIE and Travenol, which located in Sherbrooke, were given financial assistance on condition that they give hiring priority to former TCF employees.

LABOUR ADJUSTMENT PROGRAM

The third arm of the CIRP consists of the Labour Adjustment Program which was administered by CEIC as part of ILAP and is, in effect, an extension of the Adjustment Assistance Benefits (AAB) Program reviewed earlier. The beneficiaries are workers in the textile and other designated industries (clothing, footwear and tanning) who are laid off as a result of the impact of import competition or industrial restructuring. Some of the special programs, over and above the early-retirement and certification schemes reviewed earlier, include portable wage subsidies, enriched mobility assistance of up to three times the regular rate, and enriched training allowance (OECD, 1984, p. 36). Further, early-retirement benefits are available in some instances to laid-off workers over the age of 50. At the end of the 1982/83 fiscal year, 13,000 TCF workers had benefited from these programs (CIRB, 1983a, p. 10). In 1982, \$12.4 million was spent on labour-market adjustment programs to finance placement of TCF workers in institutional and industrial training programs. Enrolment in these programs was 2,952 and 931 respectively in 1982, both figures down from 1981 (OECD, 1984, p. 36). The economic recession had resulted, similarly, in a decreased use of mobility incentives in 1982 (*ibid.*, p. 37). Limited use of such mobility allowances may, in part, be a function of the relative immobility of TCF workers compared to that of other industrial workers because of the low skill and education levels and because of the high percentage of secondary wage earners in this sector. Actual expenditures on the Portable Wage Subsidy Program, which became operative in 1982, were also small; they are budgeted at \$5.2 million over a five-year period (*ibid.*).

CONCLUSIONS

The Canadian policy experience in the textile, clothing and footwear industries reflects a long-standing policy commitment to deflect adjustment forces. Employment in these sectors as a percentage of manufacturing employment and as a percentage of total employment has changed very little over the past two decades. Between 1955 and 1982, aggregate employment in textiles and knitting has fallen slightly, risen marginally in clothing, and fallen by about 26 percent in leather products. The number of establishments had risen marginally in textiles, fallen slightly in knitting, fallen somewhat more in clothing, and fallen by about one-third in leather products. The textile industry, which is relatively concentrated, did not change significantly its industrial concentration levels between 1970 and 1980. During this period, knitting mills and the leather industry, which are relatively unconcentrated, became slightly more concentrated. Thus, with the partial exception of the leather industry, no major trends in structural adjustment seem discernible in these industries over the past three decades.

High levels of tariff protection have been afforded in these industries, and in addition, quotas on imports have been deployed extensively in efforts to protect the remaining market shares of domestic producers. Protectionism has dominated all other policies as the response to pressures for adjustment. Indeed, industry spokesmen have attached little weight to subsidy programs and, for the most part, have emphasized the need for import protection. Hazledine (1981) estimates that in 1978, the economic costs of trade protection in terms of forgone consumption and production possibilities elsewhere in the economy amounted to \$137.6 million in clothing, \$98.9 million in textiles, and \$16.3 million in footwear. Little in the way of substantial industrial restructuring appears to have occurred; the Anti-Dumping Tribunal noted in 1981 that in the footwear and tanning industry, there has not been a dramatic decrease in the number of firms, and indeed there has recently been some new entry as a result of quotas.

While the Canadian government has provided substantial financial assistance to firms in these three sectors, much assistance appears to have been designed to modernize plants and improve production processes rather than to induce the orderly contraction of capacity. The assumption underlying these firm subsidies seems to have been that major elements of these industries can be internationally competitive over time with additional investment. This view does not seem to be shared by private capital markets nor, indeed, by a number of industry members, who acknowledge that wage differentials make impossible competition in many product lines with low-wage newly industrializing countries (NICs) and less-developed countries (LDCs).

Apart from trade protection and firm subsidies, labour-adjustment policies also have been directed to these sectors. However, they have

entailed modest allocations of funds, have attracted very limited “take-up”, and often have been oriented to providing extended unemployment benefits rather than subsidizing the costs of induced adjustment.

The textile, clothing and footwear industries in Canada provide a classic illustration of the policy-inversion process in declining sectors described in Chapter 1 of this study, leading to the deployment of protectionism, firm subsidies, and labour-adjustment policies, in that order, even though this ordering of policies imposes substantial direct and indirect costs on the economy and perpetuates misallocations of resources which reduce national income. This ranking of policies has changed little over time, notwithstanding that in the 1950s and 1960s, relatively long periods of sustained general economic growth afforded opportunities for absorption of resources from these sectors into other sectors of the economy. With increasing loss in international competitiveness and reduced opportunities elsewhere in the economy during the recent recessionary period, the bias simply has been to increase the level of protection. Thus, with respect to the scale of the adjustment problem faced by these sectors, little progress has been made during the past two decades, either in industry capacity or in levels of employment, in inducing orderly contraction and fundamental restructuring of the residual elements of the industries. Indeed, the problems of adjustment are now more acute than ever as declines continue in international competitiveness. As a result, the government faces the invidious choice of attempting to maintain indefinitely very high levels of trade protection or facing an extremely rapid and socially disruptive contraction of these sectors if trade protection or equivalent subsidies are withdrawn.

The Shipbuilding Industry

INTRODUCTION

Commercial shipbuilding has been an important industry in Canada since its inception in the early eighteenth century. Based on the abundant timber resources in Nova Scotia, New Brunswick and Quebec, this industry flourished, reaching a building peak of nearly five hundred ships in 1875, and ranking fourth among the merchant marines of the ship-owning nations with 7,196 vessels of over 1.3 million tons in 1878 (Canada, 1967, pp. 15–16). After that year a period of rapid decline set in as wood was replaced by steel in ship construction, until late in World War I, when the British Ministry of Shipping was instrumental in having Canadian yards build 41 ships of steel. Following the war, the Canadian government itself inaugurated a shipbuilding program in an attempt to sustain the industry, a move which resulted in some 63 ships being launched in Canada by 1921 (*ibid.*, p. 16). Yard activity slowed once more after this until World War II, when Canadian yards produced 791 ships for the navy and merchant fleet (*ibid.*).

TABLE 2-10 Trends in Canada's Shipbuilding Industry

Shipbuilding & Repair	1955	1965	1975	1980	1982
No. employees	16,829	18,586	16,344	17,185	16,128
Value of shipments (\$'000)	133,837	274,601	571,668	1,142,224	1,112,533
No. establishments	70	71	58	69	69

Source: Dominion Bureau of Statistics, *The Manufacturing Industries of Canada, 1955*, Section A (Ottawa: Queen's Printer, 1957), pp. 20–21; Dominion Bureau of Statistics, *Manufacturing Industries of Canada, 1965*, Section A (Ottawa: Queen's Printer, 1968), pp. 30–31; Statistics Canada, *Manufacturing Industries of Canada, 1980*, (Ottawa: Minister of Supply and Services Canada, 1982), pp. 8–9; Statistics Canada, *Manufacturing Industries of Canada, 1982* (Ottawa: Minister of Supply and Services Canada, 1984), pp. 8–9.

Even though the end of World War II saw some 173 ocean-going ships on the Canadian registry, this number had dropped to three by 1965, a time when dry-cargo and passenger ships (223) and tankers in the coasting trade and Great Lakes fleet (48) seemed to be predominant (Canada, 1967, p. 16, Table 1). Tables 2-10 and 2-11 indicate the trends in Canada's shipbuilding industry.

The value of shipments in the shipbuilding industry increased steadily from 1955 to 1980; the greatest increase occurred between 1975 and 1980, when the value of such shipments jumped from about \$572 million to about \$1.1 billion. Then, between 1980 and 1982, the value of shipments in the shipbuilding industry has declined by about \$30 million. The value of such shipments, however, remained significantly higher than it was 30 years ago; from 1955 to 1982, the value of shipments in the shipbuilding industry increased by 731 percent.

Employment in the shipbuilding industry remained fairly constant from 1955 to 1982. Recent statistics indicate, however, that in 1983, employment in this industry dropped significantly to an average of 7,795 in the yards of members of the Canadian Shipbuilding and Ship Repairing Association (CSSRA) (CSSRA, 1983b, p. 42). This employment drop occurred despite an increase of 11.5 percent in gross tonnage delivered, from 81,600 in 1982 to 128,700 in 1983; this large tonnage figure was almost completely accounted for by government orders for coast-guard and navy ships, which are awarded to a small number of firms in the industry.⁹

The number of establishments in the shipbuilding industry has remained fairly constant between 1955 and 1982; as of 1975, the number of such establishments had decreased by 17 percent, but by 1980, the previous level of about 70 establishments had been reached. The four-firm concentration ratio in the shipbuilding industry remained fairly high and constant between 1954 and 1976, but has decreased by about 10 percent since then.

TABLE 2-11 Concentration in Canada's Shipbuilding Industry

	1954	1958	1965	1968	1970	1972	1974	1976	1978	1980
Shipbuilding & Repair	63.8	66.1	65.5	63.4	61.8	63.7	66.5	62.7	54.0	56.4

Source: Statistics Canada, *Industrial Organization and Concentration in the Manufacturing, Mining, and Logging Industries, 1980* (Ottawa: Ministry of Supply and Services Canada, 1983), p. 62.

Note: Concentration is measured by the leading four enterprises' share of industry shipments, weighted by value-added of each industry.

GOVERNMENT INTERVENTION

Prior to May 1961, subsidies were provided to the shipbuilding industries only on a limited basis. The rationales for these subsidies were to maintain a defence base, to maintain yard employment, and to expand commercial demand. Reasons for maintaining the subsidies since that time, however, have been largely centred on political and regional considerations: the shipyards are located in such places as Lauzon and Sorel in Quebec; Marystown, Newfoundland; Saint John, New Brunswick; and elsewhere in the Maritimes. They are major sources of employment in these areas, where alternative job opportunities are lacking. It also has been argued that Canada, as a major trading nation, must have adequate ship-repair facilities adjacent to its major ports. Furthermore, it is claimed that the shipbuilding industry employs, and hence ensures the availability of, a significant pool of skilled tradesmen. Approximately 50 percent of the shipbuilding work force consists of skilled tradespersons and 25 percent of semi-skilled. The industry also produces secondary industrial benefits (for the steel industry, for instance), enhances national security through its capability of building warships for defence, and encourages frontier development by building vessels for exploration and other purposes in the Arctic.

The problems facing the industry today are arguably rather different, at least in part, from the problems facing the textile, clothing and footwear industries and the automotive industry. It is not necessarily or exclusively low-cost imports deriving from inexpensive labour with which Canadian shipbuilders are attempting to compete, but rather low-cost imports that result from heavy foreign-government subsidies.

The federal government initially placed part of its shipbuilding-policy emphasis on fiscal incentives such as direct subsidies to shipyards that built for domestic or export customers, but since 1979, successive governments have sought to eliminate the program. Other policy initiatives have included government procurement of warships and icebreakers built in Canadian shipyards; the provision of financing through the Export Development Corporation and, to a lesser extent, through CIDA; the granting of a higher rate of capital-cost allowance to Canadian shipowners buying from Canadian shipyards; and direct assistance to the shipyards under DREE, IMDE and other government programs.

TARIFF PROTECTION

The Canadian shipbuilding industry has received only nominal tariff protection against foreign competitors. Although the normal duty rate under Tariff item 44000-1 is 25 percent for ships imported into Canada, until June 30, 1983, and the passage of the *Customs and Excise Offshore Application Act*, it was possible to import duty free ships built in the

British Commonwealth (Canada, 1978a, Appendix 1, p. 10). Ships from developing nations such as South Korea (the world's second-largest shipbuilding country) were dutiable at one-half the normal rate. Since the passing of this Act in 1983, however, all imported ships except fishing vessels 30.5m (100 ft.) or longer, regardless of country of origin, are subject to 25 percent duty, while rigs are dutiable at 20 percent. The only exceptions to such duties are fishing vessels, which are admitted into Canada duty free. Despite pleas by the Canadian Shipbuilding and Ship Repairing Association (CSSRA) to terminate this exemption and despite election promises by the Progressive Conservative Party to change this regulation on election, no action has yet been taken.

Other relevant tariff items include 44002-1 and 43935-1. The former covers all vessels other than those entitled to engage in the coastal trade, applying a rate of duty of 15 percent British Preferential (BP) and 25 percent for all others (Canada, 1978a, Appendix 1, p. 10). The latter provides free entry (British Preferential (BP) and Most Favoured Nation (MFN)) for fishing vessels of which the registered length is more than 100 feet (*ibid.*).

SUBSIDIES

Direct subsidies have been another major instrument of assistance to the shipbuilding industry. Indeed, the subsidization of shipbuilding can be viewed as a substitute for tariff protection in the case of ships built in Commonwealth countries. Table 2-12 shows how the rate of subsidy in Canada has been decreasing fairly regularly since its adoption. The subsidy is a percentage of the approved cost of work performed in the construction of ships in Canada.

The subsidy regulations of 1961 empowered the Minister of Transport to stipulate the amount of Canadian material that was to be incorporated into a ship in order to qualify for the subsidy under the Canadian-content regulations. The Ship Construction Association Regulations of 1962 required the Canadian Maritime Commission to ensure that these conditions were met. The Canadian content provision was discontinued, however, in 1966.

The so-called Escrow Plan encouraged the building of ships for export during the 1950s. Under this plan owners were allowed to sell certain wartime-built cargo vessels on condition that they spend the proceeds for replacement in Canadian shipyards. When the subsidy was introduced in 1961, however, it was not intended to promote exports. On the contrary, the Ship Construction Assistance Regulations (1961-66) and the Ship Construction Subsidy Regulations (1966-75) required prospective owners to covenant that subsidized ships would be kept on the Canadian registry for at least five years after completion.

It was not until the end of 1970, when domestic orders had fallen

TABLE 2-12 Rate of Subsidy for Canada's Shipbuilding Industry

Time Period	Percent
12/05/61 to 31/03/63	40
01/04/63 to 02/02/65	35
03/02/65 to 31/12/65	suspended
01/06/66 to 31/05/69	25
01/06/69 to 31/05/70	23
01/06/70 to 31/05/71	21
01/06/71 to 31/05/72	19
01/06/72 to 05/03/75	17
01/01/76 to 31/12/76	13
01/01/77 to 01/03/77	12
01/03/77 to 31/05/85	20
01/06/80 to present	9

Source: CSSRA, *A National Strategy for the Shipbuilding, Ship Repairing and Allied Industries* (Ottawa: March 1, 1977), p. 5; for June 1, 1980 rate see *Seaports and the Shipping World* (December 1970), p. 32.

drastically and layoffs in the shipbuilding industry generally had aggravated Canada's regional unemployment problems, that the federal government introduced the Shipbuilding Temporary Assistance Program (STAP) to promote exports again. STAP provided for subsidies (at rates varying from 14 to 17 percent) on ships built for export and was successful in attracting approximately \$1.3 billion worth of orders to Canadian shipyards (Canada, 1978a, Appendix 1, p. 19). The previous subsidy program remained in effect for domestic contracts during this period.

When STAP was introduced, all indications suggested that it would be a temporary measure to stimulate employment in Canada's shipbuilding industry. A deadline of June 30, 1972 was set for the signing of export contracts, and the regulations stipulated that:

Before declaring a vessel to be an eligible ship the Minister shall consider . . . the ability of the shipbuilder to carry out the terms of the contract without having to overexpand his facilities in relation to anticipated long-term demand.¹⁰

The program was extended, however, until the creation of the Shipbuilding Industry Assistance Program (SIAP) because of the lobbying efforts of the CSSRA for a long-term program of assistance (Sigurdson, 1972). Requirements for Canadian content similar to those in the initial legislation were also reinstated:

Before declaring a vessel to be an eligible ship the Minister shall consider . . . the benefits to Canada through the use of Canadian materials and components.¹¹

In 1975, the government announced a new program and refused to accept further applications under the older programs noted above. The Shipbuilding Industry Assistance Program offered the same rate of subsidy

whether a ship was being built for export or for a Canadian owner. The initial subsidy rate was set at 14 percent and was to decline by 1 percent each year (Canada, 1985, Appendix B). Changes were made to this scheme when world shipbuilding began to slow down. In 1976, conversions were made eligible for assistance, and in March 1977, the rate of subsidy was raised to 20 percent. A productivity-improvement grant of up to 3 percent of the cost of vessels entitled to subsidy or purchased by the federal government was also made available, as long as an equal shipyard investment was made for approved performance improvement leading to an upgrading of facilities (*ibid.*). Two limitations were initially imposed on the eligibility of shipbuilders seeking assistance under the SIAP. Under these limitations, the shipbuilders had to be incorporated, and they had to pass an examination by a committee with the Department of Industry, Trade and Commerce to verify that they were in the shipbuilding and repair business on a permanent basis. The latter limitation has since been abandoned because of pressure from steel fabricators and others involved in certain forms of vessel construction. The government's reasons for the introduction of SIAP were not unlike its reason for its other interventions: the desirability of maintaining employment in areas of low alternative employment; the need for a marine infrastructure to support Canada's role as a world trader; the desire to support or maintain a pool of skilled labour; and the desire to reinforce arctic sovereignty. The program was designed to maintain and improve the industry's viability and competitiveness in building for new domestic and foreign orders in the face of foreign competition (*ibid.*). Table 2-13 shows the amounts of subsidy disbursed in each year, by province, from 1961 to 1978, under the various programs noted above.

GOVERNMENT PROCUREMENT

Government procurement, although subject to fluctuation, has followed, until recently, a downward trend over the years as an element of total shipbuilding activity (CSSRA, 1977, Annex H). Government orders accounted for 27 percent of the industry's output in 1960, an average of 23.8 percent from 1963 to 1972, 10 percent in 1973, 7 percent in 1974, and 10 percent in 1975 and 1976 (Canada, 1978a, Appendix 1, p. 13; CSSRA, 1977, Annex H). While the government's share of the value of new construction and of repairs and conversions increased to 14.4 percent and 19.7 percent respectively in the first half of 1977, the first half of 1978 saw the government's share of the value of new construction fall back to 10.4 percent, while its share of repair and conversion work increased to 29.3 percent (CSSRA, 1978, p. 44). In the last few years, government procurement (with respect to new construction at least) has become even more erratic.

Federal government contracts as a percentage of industry output

**TABLE 2-13 Ship Construction Subsidy; Shipbuilding Temporary Assistance; Shipbuilding Industry Assistance;
Amount of Subsidies, Grants and Contributions Paid by Province, by Fiscal Year**

Province	(5 years)		(2 years)	
	1961-66	1966-71	1971-73	1973/74
B.C.	31,049,353.31	22,122,250.74	7,010,953.86 ^a	8,988,509.19 ^a
Alta.	—	1,611,941.45	873,735.58	545,244.06
Man.	100,605.05	504,013.72	86,254.99	—
Ont.	31,507,328.55	23,543,585.23	6,046,252.33 ^a	3,347,285.12 ^a
Que.	44,526,617.04	39,600,248.37	11,746,516.19 ^a	11,816,443.24 ^a
N.B.	16,415,731.67	9,040,028.40	5,902,525.12 ^a	3,161,255.61 ^a
N.S.	12,188,561.28	23,609,831.93	8,281,724.48 ^a	3,980,839.10 ^a
Nfld.	662,748.62	2,186,752.99	1,272,801.02	2,623,887.96
P.E.I.	588,000.00	3,193,500.00	516,002.09	36,535.72
Total	137,037,945.52	125,412,132.83	41,736,765.66 ^a	34,500,000.00 ^a

Province	1974/75	1975/76	1976/77	1977/78	Total
B.C.	10,499,472.44 ^a	14,987,212.10 ^a	7,186,185.68 ^a	4,519,085.34 ^a	106,363,022.66 ^a
Alta.	—	274,621.06	245,980.48	—	3,551,522.63
Man.	—	193,566.42	—	—	884,440.18
Ont.	4,636,333.55 ^a	6,040,429.31 ^a	9,660,004.48 ^b	12,070,521.61 ^b	96,851,720.18 ^b
Que.	14,417,875.02 ^a	22,207,070.28 ^a	23,400,924.73 ^a	24,322,099.59 ^b	192,036,794.46 ^b
N.B.	6,502,511.28 ^a	6,907,701.75 ^a	15,271,135.63 ^b	8,824,408.98 ^a	72,025,298.44 ^b
N.S.	6,288,375.85 ^a	4,269,562.85 ^a	11,121,129.60 ^a	3,643,058.75 ^b	73,383,083.84 ^b
Nfld.	2,634,810.86	3,057,973.23	1,114,639.40	1,205,882.00	14,759,496.08
P.E.I.	20,621.00	61,863.00	—	20,621.00	4,437,142.81
Total	45,000,000.00 ^a	58,000,000.00 ^a	68,000,000.00 ^b	54,605,677.27 ^b	564,292,521.28 ^a

Source: Canada, Department of Industry, Trade and Commerce, *Report of the Sector Task Force on the Canadian Shipbuilding and Repair Industry* (Ottawa: The Department, 1978).

a. Includes *Shipbuilding Temporary Assistance Program* figures.

b. Includes *Shipbuilding Industry Assistance Program* figures.

increased from 3 percent in 1979, to 6 percent in 1980, to 2 percent in 1981, to 81 percent in 1983 (CSSRA, 1981b; 1981d, p. 42; 1983c, p. 42). In fact, 1983 was the first year since 1939 that virtually all new orders were for government vessels. Meanwhile, the government share of the actual repair and conversion work continued to be relatively more stable, remaining constant in dollar terms, though decreasing its share to 20.1 percent in 1979, increasing again to 25 percent in 1980, but falling back to 18 percent in 1981 (CSSRA, 1979, p. 41; 1981d, p. 42).

Government procurement originates from a number of different fleet operations in a variety of government departments such as the Departments of Transport, National Defence, Environment, Fisheries, Public Works and the RCMP. A consistent industry recommendation has been that government procurement should be used to stabilize demand, and that the government should maintain a number of vessels on a "shopping list," to be held in reserve for periods of slack demand in the commercial part of the industry. Among recent federal government procurements were the government's \$70 million commitment to ship construction and repair facilities in 1979/80. An even larger recent procurement project has been the \$3.8 billion Canadian Navy Frigate Replacement Program which, it is claimed, will provide approximately 30,000 person-years of employment to Canadian industry, including 7,000 person-years of shipyard employment. Still other procurement projects include \$340 million in federal contracts to seven shipbuilding companies for the construction of Canadian Coast Guard and Fisheries and Ocean vessels, \$3 million worth of repair work for two National Defence Vessels, and \$4,186,000 worth of federal work projects granted to Marine Industries Ltd. of Sorel, Quebec, Daire Shipbuilding Ltd. of Lauzon, Quebec, and the Saint John Shipbuilding and Dry Dock Co. Ltd. of Saint John, New Brunswick ("\$340 Million," 1983; "Three Shipyards," 1983). The cost of these latter shipbuilding contracts is being borne by the \$2.4 billion Special Recovery Capitals Project (SRCP) Program outlined in the federal budget of April 19, 1983, in conjunction with the SIAP. The projects covered under SRCP are designed to spur economic recovery and to put in place key facilities and services to enhance economic and regional development opportunities for the private sector ("\$340 Million," 1983).

FINANCING AND THE IMPORT PROBLEM

For many years the Canadian Shipbuilding and Ship Repairing Association (CSSRA) has been emphasizing the need for the federal government to recognize the importance of financing in ensuring successful implementation of government policy. By financing, the association refers to the fiscal, monetary and legislative policy environment over which government exercises direct control, and to specific vehicles which guarantee availability of funds to those buying ships built in Canadian

yards, whether those buyers are Canadian or foreign (CSSRA, 1977, p. 20). It argues that the Canadian situation must be viewed in light of the policies in other countries with which Canada competes for shipbuilding orders.

A problem of asymmetry in the position of foreign and domestic purchasers arises in Canada because, while a foreign operator is eligible for both subsidized construction (through SIAP) and subsidized financing (through the Export Development Corporation), the Canadian operator is eligible only for subsidized construction. The Export Development Corporation currently provides two types of financial support for exports. One is the insurance of export credit normally provided by the Canadian chartered banks on terms of up to five years, while the other is the provision of direct loans extending beyond five years. Given this asymmetry between Canadian and foreign purchasers, it is not unusual for a Canadian purchaser to shop abroad where the firm can take advantage of both subsidized financing and subsidized construction. Asymmetries like this also led to the 13 shipbuilding members of the Organisation for Economic Co-operation and Development (OECD), including Canada, agreeing, in 1969, to limits on government-based financing terms for the export of vessels. This arrangement was then amended in 1970, 1974 and 1975, and was generally observed until 1976 (Canada, 1978a, Appendix 1, p. 9). Adherence to these limits stopped at the start of the world shipbuilding crisis. The year 1979 saw the establishment of the OECD Understanding on Export Credits for Ships from December 1, 1979, onwards. This document called for a minimum down-payment of 20 percent and maximum credit of eight and a half years, at an interest rate of 8 percent (CSSRA, 1981a, p. 71).

Historically, the Canadian industry has existed to serve the Canadian market for government, commercial and fishing vessels. Exports were not of great importance until the 1971–75 period, when the combination of a surge in world demand for ships and STAP subsidies enabled Canadian industry to penetrate the foreign market to the extent that 70 percent of tonnage built in 1974–76 was exported (CSSRA, 1981a). With the slump in world markets that followed the oil crisis of 1973, except for an order in 1976 for five tugs from Norway, there were no new export orders placed in Canada for a period of 18 months (CSSRA, 1977, p. 7).

A 1984 report by Drewry Shipping Consultants concludes that Europe's shipbuilding industry has been propped up by some £4 billion in publicly acknowledged subsidies in recent years, and that this amount apparently represents merely the "tip of the iceberg". Drewry provides the following details of subsidies on a national basis:

United Kingdom: £800 million in state subsidies since 1979, with the government seeking a doubling of the [European Community] intervention fund to 35% of shipbuilding price.

France:	£130 million allocated to the industry last year, with a further £54 million at the turn of the year.
Italy:	Aid for newbuilding contracts, intervention subsidies and scrap and build provisions amounted to £240 million last year.
West Germany:	£65 million made available by the federal government for 12.5% newbuilding aid this year for owners ordering domestically, and a further £20 million in 1985 and 1986. Shipbuilding states are financing a three-year programme to obtain export orders.
The Netherlands:	£90 million government aid since 1977, and although the industry is faced with the prospect of no further support beyond next year, there are signs the government may relent.
Denmark:	Yards persist in not wanting direct subsidies, although attractive financing is offered by the national ship credit fund.
Sweden:	Over £1 billion injected into shipbuilding between 1975 and 1983. Restructuring aid of £520 million was agreed for the period to 1986.
Norway:	Government maintains that subsidies will have to be wound up, but decision to end aid in 1982 was not put into effect. Between 1979 and 1983, aid amounted to £340 million.
Finland:	Government recently granted interest subsidies for two ferries built at Wartsila.
Spain:	Banco Central is to lend £640 million for the construction of nine cruise ships (Shipping Reporter, 1984).

Canada, it will be recalled, offers only a 9 percent subsidy to potential domestic purchasers; government procurement is a less stable additional form of assistance.

In terms of long-term lease-and-loan rates for OECD countries in general, Canada's 1977 rates ranged from 10 to 11 percent for fixed rates, while the OECD rates were 8.5 percent. The maximum term available for Canadian financing was 10 to 15 years, while that for OECD was only eight years (CSSRA, 1977, p. 21). The CSSRA's figures for 1981 put Export Development Corporation (EDC) financing in the 12 to 14 percent range, while that of some countries is as low as 6 percent and that of others

stands at 7 to 8 percent, interest-free for the first two or three years (CSSRA, 1981a, p. 53). The discrepancy in rates is highlighted in the CSSRA's estimate that if the Canadian government were to provide loan guarantees and/or tax incentives to a lender/lessor whereby the lender/lessor could then reduce vessel financing costs from 10 percent to 7.91 percent, the result would be equivalent to the government's providing a 10 percent subsidy on the cost of the vessel (CSSRA, 1977, p. 20). An example of a lost sale as a result of financial "distortions" is Canadian shipowners' purchase of three ocean-going lakera in the United Kingdom. Financing is believed to have cost 7.5 percent as against 23 percent in Canada, providing, in effect, a direct subsidy in the 60 percent range (CSSRA, 1981a, p. 53).

The increasing level of imports in Canada in the last decade adds significance to these issues, especially given the industry's assertions that the gap between Canadian industry's costs and those of competitors in the United Kingdom and Western Europe have narrowed in recent years, and that in some instances Canadian costs are even lower than its competitors' (CSSRA, 1977, p. 5). From 1980 to the end of September 1984, 143 foreign-built vessels with a total tonnage of 614,869 were registered in Canada (CSSRA, 1984b, pp. 8-9). Although the balance of domestic and export tonnage to import tonnage appeared to be in Canada's favour as late as 1981, the CSSRA was already pushing for a change in import policy. The association claimed that the figures were deceiving, and that the balance was actually extremely unfavourable because Canada's deep sea fleet was 98 percent under foreign registry and of foreign build (*ibid.*). In addition, the Great Lakes sale had just been concluded, representing the first time that ships had ever been imported for the Great Lakes trade.

By the end of October 1981, the total for that year for foreign-built vessels registered in Canada already stood at 31 with a gross tonnage of 136,587. The gross-tonnage figure proved to be 138 percent higher than that for 1980 during the same period (CSSRA, 1982a, p. 40). Tables 2-14 and 2-15 show in more detail the registration of foreign vessels during various periods (*ibid.*, p. 41) and United Kingdom- and Commonwealth-built vessels registered in Canada (*ibid.*, p. 42; "\$340 Million," 1983). Another indication of the deteriorating domestic market share of Canadian shipbuilders is that of the \$1.5 billion worth of Canadian shipowner and oil-company orders in the year and a half preceding March 1982, nearly two-thirds or \$1 billion worth of the orders went abroad (CSSRA, 1982c, p. 42). There were 67 imports of foreign-built vessels from mid-1980 to mid-1982, while new domestic orders from CSSRA yards numbered only 32 (CSSRA, 1982b, p. 44). In all, from the date of the reduction in SIAP from 20 percent to 9 percent (July 1, 1980) until August 1983, 100 foreign-built vessels were registered in Canada, while only 51 commercial orders were sourced in Canada (*ibid.*). The figures for 1982 had

TABLE 2-14 Foreign-Built Vessels Registered in Canada, 1968-80

Year	Number		Gross Tonnage	
	Annual	Cumulative	Annual	Cumulative
1968	13	13	15,000 ^a	15,000
1969	1	14	20,000 ^a	35,000
1970	18	32	29,000 ^a	64,000
1971	6	38	10,000 ^a	74,000
1972	18	56	43,000 ^a	117,000
1973	6	62	15,361 ^a	132,361
1974	17	79	77,000 ^a	209,361
1975	22	101	125,730	335,091
1976	21	122	103,367	438,458
1977	30	152	164,514	602,972
1978	14	166	67,275	670,247
1979	36	202	61,068	731,315
1980	31	233	70,549	801,864

Source: CSSRA, "Foreign Built Vessels Registered in Canada," *Seaports and the Shipping World*, (January 1982), p. 40.

a. Estimated

TABLE 2-15 United Kingdom- and Commonwealth-Built Vessels Registered in Canada, 1971-81 (October)

Year	Number of Vessels	Gross Tonnage
1977	8	20,028
1978	3	5,200
1979	12	16,908
1980	3	2,481
1981 (Jan. to Oct.)	3	12,446
Total	29	57,063

Source: Prepared by the CSSRA, November 27, 1981.

become even worse as 47 foreign vessels were registered, compared to only 10 orders received by domestic yards by August 1982. In tonnage terms the difference was even greater: it stood at 50 to 1 (CSSRA, 1983b).

DEMANDS FOR ADDITIONAL GOVERNMENT SUPPORT

With the major growth in imports has come heightened pressure for changes in government shipbuilding policy. Now, however, accompanying the calls for more generous domestic and export-financing subsidies and for the withdrawal of Commonwealth duty exemptions are calls for the elimination of provisions contained in other government policies which are claimed to be inconsistent with the Canadian shipbuilding policy, such as Petroleum Incentive Program (PIP) grants, and for changes in the laws governing temporary imports. Recent policy changes include:

- extension of Canadian customs and excise laws to vessels used in resource exploration and development on Canada's continental shelf beyond the current 12-mile territorial limit;
- retention of performance improvement grants currently available under SIAP (approved January 6, 1983), a more uniform application of existing rates of duty on ships under the Customs Tariff, and an extension of the production assistance under SIAP on ships to be completed and delivered by July 1, 1985; and
- adoption of coastal trade policies that will encourage fuller participation in the coastal trade and related commercial activities, other than fishing, by Canadian ships.

The government indicated, however, that it would not modify its policies on temporary imports. The industry lobby (CSSRA) continues to challenge the present policy which allows companies to charter foreign-built equipment on a temporary basis and to pay duty at a fraction of the normal rate when entering regular service. (This rate is currently 1/120th per month of the value of the vessel.) In the first eight months of 1983, there were 94 temporary entry approvals, of which 51 were for the east coast offshore area, which is the area suffering most in the current slump (CSSRA, 1983b). The CSSRA argues that to be effective, the temporary entry duty must be brought into line with the permanent entry rate; it claims that only then is it likely that commercial orders in Canadian shipyards will replace some temporary entries. In a recent brief to the Royal Commission on the Economic Union and Development Prospects for Canada, the CSSRA reaffirmed its position on the need to bring the temporary rate to the permanent level. It argued that as a minimum step, the temporary rate should be doubled (CSSRA, 1983a). In addition, it maintained that a time period of 90 days should be required between the making of an application for temporary entry and the date the vessel is required.

In addition, both the CSSRA and other interests have often called for the government actively to promote spin-offs for Canadian shipbuilders from both arctic exploration and resource exploration for offshore oil and gas (CSSRA, 1977, p. 10; Vancouver, 1983, p. 24). In particular, a coalition of the City of Vancouver, the shipbuilding industry, and the maritime unions argued recently that the government should place greater emphasis on marine-equipment plans in approving the Canadian Industrial Benefit proposals under Bill C-48, *The Canadian Oil and Gas Act*. They claim that the provisions of this existing legislation have not been used to maximize opportunities for the Canadian shipbuilding and shipping industries because many vessels are still bought or leased offshore, and many operate under foreign charter (Vancouver, 1983, p. 25). Connected to this issue is the call by industry members for a reassessment of the Petroleum Incentive Program (PIP) of the National

Energy Policy. The PIP grant regulations provide grants of up to 80 percent of operating costs for petroleum-exploration activity. As leasing of equipment is considered an operating cost, but capital investment is not, only leasing expenses create eligibility for the grants. The PIP grants therefore tend to encourage leasing of existing vessels from abroad, thereby inhibiting the construction in Canada of new vessels for offshore energy exploration (*ibid.*). The lobby of the CSSRA and the City of Vancouver therefore advocate a revision of existing policies to maximize Canadian content. Both parties point out that this change could be brought about without violating GATT because it could be argued that the domestic industry is being threatened by import competition as covered by Article XIX of GATT rules. In 1979, the government required that Arctic-class vessels be registered, but not necessarily built, in Canada, a decision that came as a major disappointment to the Canadian industry (Andras, 1979, p. 36). The potential for a Canadian share of the Arctic and offshore market is of great importance to members of the Canadian industry, given their expectation of a demand for ships and related equipment in the Arctic, to the amount of some \$33 billion between 1982 and 1991. Twenty-five billion dollars of this amount is expected to stem from Arctic and offshore exploration and development ("Shipbuilding," 1981).

A drop in the price of secondhand ships has accompanied the falling world demand for vessels and has also been a factor in the rising scale of imports. While Canadian shipbuilders were devoting much of their effort to the export market, Canada imported a significant number of secondhand ships to satisfy particular needs of the domestic market. In 1975, 13 used vessels totalling 106,438 gross tons were imported and in 1976, 17 used vessels totalling 98,380 gross tons (CSSRA, 1977, p. 5). Such a trend combined with the first-ever importation of ships for the Great Lakes trade led the CSSRA to recommend at that time that the government should impose a temporary ban or restriction on the importation of ships for Canadian registry for coastal and internal operations. The Department of Transport has been reluctant to adopt this recommendation, despite the tendency of the secondhand imports to reduce the average quality of the Canadian merchant marine, because not all industries can be served economically by new ships (Canada, 1978a, Appendix 1, p. 9).

The CSSRA made other recommendations to the Consultative Task Force on the Canadian Shipbuilding Industry (1978), on which the government, at the time of its response, did not act. These recommendations included a call for the elimination of the valuation rule imposed by tariff items 44000-1 and 44002-1 and its replacement with the application of the 25 percent customs tariff to the replacement value of the ship; they also include a call for a requirement, to be upheld by new coastal legislation, for all foreign-built Canadian-registered ships to have all

applicable customs duty paid (that is, to impose duty on imported used ships) (CSSRA, 1977, pp. 7–8). The Sector Task Force on the Canadian Shipbuilding and Repair Industry, established several months later, made its recommendations with respect to used ships much more general than had the CSSRA. It called for a review of all applications to admit foreign vessels and proposed that the criteria for approval should involve not only an appraisal of the safety of the vessel, but also an evaluation of the economic impact of the applicant vessel on Canadian shipping, on Canadian-related trade, and on the industrial development of the Canadian shipbuilding industry. In addition, it called for a ban on the import of ships over 10 years of age and for the application of the 25 percent duty on currently duty-free British Commonwealth ships (Canada, 1978a, p. 8). The latter recommendation has since been adopted. The government's response to the former recommendation was qualified; the government agreed only that it would continue to monitor what it called the "complex" question of importation (Andras, 1979, p. 37).

CONCLUSIONS

The period from the end of World War II to the mid-1970s saw significant growth in the shipbuilding and ship-repair industry. Since the early 1960s, however, the industry has become increasingly dependent on government subsidies and procurement to maintain output and employment levels. As Japan and other NICs entered the industry, world demand declined for many types of commercial vessels, and corresponding excess capacity developed in the industry world wide. As a result, Canadian shipbuilding yards have faced increasing foreign competition for orders in both domestic and export markets. In addition, much of the foreign competition has been subsidized by home governments with respect to both construction costs and financing costs faced by purchasers.

The Canadian government essentially has responded in kind, offering local shipbuilders subsidies as a percentage of construction costs, beginning with a 45 percent subsidy in 1961 and reducing that amount to 9 percent at the present time. Additional subsidies are provided for the financing of orders for export. Government procurement has also periodically provided a major source of industry demand and currently constitutes an overwhelming proportion of new orders which, in part, offset in an indirect way the reduction in the explicit subsidy. Trade protection has not formed a large part of government assistance to the industry, although Hazledine (1981) estimates that for 1978, the economic costs of trade protection for the industry still amounted to \$43.3 million.

Employment in the industry was fairly constant from the early 1950s to the early 1980s, but lately it has plummeted dramatically. Recent sub-

stantial government procurements may partially counteract this trend. The number of establishments in the industry has remained almost constant over this period; high levels of industrial concentration have fallen slightly over time. In short, there is little evidence of significant structural adjustment, but there is evidence of increasing government dependency.

The present plight of the shipbuilding industry in Canada poses a difficult dilemma for policy makers. Evidence tends to suggest that at least historically, the industry possessed some comparative advantage in construction of vessels for Great Lakes shipping, the coastal trade, and the fishing industry. In the future, construction of ships, rigs and related equipment for the Arctic may offer similar possibilities. However, the welter of subsidies to their shipbuilding industries provided by most of the major shipbuilding nations now hopelessly obscures underlying comparative advantage and renders it difficult to separate these effects from those related to genuinely lower costs of production in countries such as Japan and other NICs.

Whatever the relative weight of these factors, there is a compelling case to be made that if foreign governments wish, for whatever reason, to subsidize ship construction in their own countries, a rational economic posture for this country is to encourage local purchasers to exploit the foreign subsidies ("take their money and run"). This action would then free up resources, both subsidy dollars and existing labour and capital committed to the industry, to be allocated to activities where the returns are higher (Trebilcock and Quinn, 1979, p. 101). As Krugman (1984, p. 17) points out:

In practice, an industrial policy aimed at meeting foreign [subsidized] competition would probably lead to government encouragement of investment precisely where the returns to investments are depressed by the targetting of other governments.

To match subsidy with subsidy is to allow ourselves to be caught in an upward spiral of subsidies with strong negative sum properties. Where it is perceived that the foreign subsidies are likely to be temporary or intermittent, the case for adopting a strategy of non-response is weaker, if disruptive impacts on local producers and purchasers are to be avoided. This, of course, suggests an alternative strategy: to attempt to negotiate tight and enforceable international constraints on construction and financing subsidies, and to continue to provide domestic subsidies only as long as these negotiations are being pursued actively. If foreign subsidies emerge from this exercise as a permanent fact of life, a compelling case would then seem to exist for reorienting our current domestic-subsidy policies toward inducing orderly contraction of the industry (by subsidizing some of the costs of mergers, rationalizations, and scrapping of physical capacity) and underwriting a substantial portion of

the adjustment costs of labour to encourage re-employment in other sectors.

The Cape Breton Coal Industry

INTRODUCTION

On July 7, 1967, an Act of Parliament establishing the Cape Breton Development Corporation (DEVCO) received assent. This federal Crown corporation was established to operate those coal mines formerly owned by the Dominion Steel and Coal Company (DOSCO) and to diversify the Cape Breton economy with a view to reducing the island's chronic dependence on a limited number of industries and especially on coal. Problems in the Cape Breton coal industry were not new; they had been studied by the Carrol (1947), Gordon (1957) and Rand (1960) Royal Commissions. The establishment of the Crown corporation followed the recommendations of yet another commission, the Donald Royal Commission on Coal (1965), which emphasized the social, political and economic problems caused by long-term dependency on coal mining, and argued that the future of Cape Breton should not be based on that industry. Central to the Commission's recommendations were the facts that the production of Cape Breton coal was uncompetitive and uneconomic and totally dependent on government subsidies for its continuation (Matthews, 1971, Appendix B, p. 136). The report recommended public ownership of the Cape Breton collieries in order to ensure a gradual, rather than an abrupt, phasing-out of unprofitable mines and to avoid major employment dislocation.

The recommended phasing-out of coal production stemmed from the serious economic plight of Cape Breton coal mining at the time of the Donald Commission. The Cape Breton coal industry had long suffered the problem of financial instability, partly because of inability to compete with oil and gas as the dominant sources of energy in the postwar period and partly because of a history of low productivity. Contributing factors to the industry's economic difficulties have been its inherently high operating costs, reflecting the facts that the mines were technologically outmoded, inefficient and labour intensive; its distance from ready markets, which increased transportation costs; strong competition from United States mines, such as those in Pennsylvania, for central Canadian markets; engineering difficulties caused by the fact that the major coal deposits are suboceanic rather than subterranean; and its history of management/labour problems (Tupper, 1978, p. 333). High sulphur content in Cape Breton coal also led to its replacement by higher quality imported coal in mills such as the Sydney steel mill.

Although the Cape Breton economy had faced many difficult times because of these problems, the 1960s brought difficulties of unprece-

dented proportions. There was massive unemployment, rapid deterioration of the coal industry's market, DOSCO's decision to close its coal mines, and widespread layoffs in DOSCO's Sydney steel mill. High operating costs and dwindling markets resulted, between 1961 and 1967, in closures of mines which employed 2,911 men. Central to this crisis was the relatively high cost of DOSCO's coal compared to other coals; while the pithead price per ton of DOSCO coal was \$12.23, that for Pennsylvania coal was \$4.50, and while the delivered price of DOSCO coal in Toronto was \$16.61, that for Pennsylvania coal was \$8.96 per ton (Tupper, 1978, p. 337).

As the crisis deepened, federal government assistance to the Cape Breton coal industry increased substantially. Compared to subvention assistance of less than \$100 million provided between 1928 and 1960, subvention payments in the period 1960 to 1966 were \$88,490,915; \$22 million of this amount (that is \$3,000 per employee) was paid in the year 1964/65 alone (Tupper, 1978; Matthews, 1971, p. 136). Trends at the time of the Donald Commission's report suggested that this need for government assistance would continue. Extensive capital investments in mine renovations well beyond the scope of existing government subsidies would be required (Matthews, 1971, p. 136). The cost of this needed investment was estimated at \$25 million for rehabilitation and \$10 million for a new mine at Lingan (Tupper, 1978, p. 337). Only five DOSCO mines remained in Cape Breton, production had shrunk to 4.3 million tons per annum (about 60 percent of what it had once been), and the labour force had dropped to about 6,500 persons after the almost 3,000 layoffs that occurred between 1961 and 1967 (George, 1981). DOSCO had told the federal government in 1965 that if the government did not provide additional financial support for modernization, it would abandon the mines. After the federal government appointed a committee of senior officials to evaluate DOSCO's demand and had granted the \$25 million the company had requested, DOSCO unexpectedly reversed its position and announced that despite this additional assistance, it planned to discontinue coal mining in Cape Breton.

This decision had grave consequences for Cape Breton, since it meant more mine closures in an already depressed region. It also limited the options available to federal decision makers; the federal government could either take over the DOSCO collieries or allow the industry to collapse. The decision to maintain the Cape Breton coal industry through state enterprise, as with previous public-assistance decisions, was largely influenced by the concern to provide continued employment for a large labour force. The industrial work force of 135,000 in Cape Breton depended almost exclusively on the coal industry and on the steel plant that had been established (also by DOSCO) in the area to take advantage of available coal supplies. At the time of the public take-over, the DOSCO coal-mining force represented 14 percent of the entire Cape

Breton labour force and 6,500 of the 7,500 jobs in coal mining. In terms of production, DOSCO mines produced 3.7 million tons of the total 4.3 million tons of coal produced on the island (Tupper, 1978, p. 332).

The major part of Cape Breton coal mining is concentrated in Cape Breton County, which includes Sydney, Glace Bay, New Waterford and Sydney Mines. These communities account for 76 percent of Cape Breton's population, and between 38 percent and 56 percent of the workers in the smaller three communities are coal miners (Tupper, 1978, p. 332).

THE CREATION OF CAPE BRETON DEVELOPMENT CORPORATION

These problems led Dr. Donald to recommend the establishment of a Crown corporation to develop a strategy for closing down the mining operations in Cape Breton by 1981 and to halve coal output to 2.1 million tons per annum by 1971. It was estimated that by halving output, the government would save \$150 million in subsidies (Matthews, 1971, p. 137). The Commission argued that only a public corporation could provide the commitment needed to find a long-term solution which would entail the phasing out of coal mining, while simultaneously redeveloping the Cape Breton area in such a way that abrupt and widespread unemployment would be avoided. After receiving the Donald Commission's report, the federal government held meetings with DOSCO, trade unions, the Nova Scotia government, and other Cape Breton interests and adopted a plan that largely reflected the Commission's recommendations. Ottawa would take over all mining in the Sydney coalfield, while Nova Scotia would assume responsibility for all other provincial coal mines. The federal government tabled proposed expenditures on the mines of the \$25 million needed for mine rehabilitation (even though Dr. Donald had suggested that expenditures of only \$14 million were necessary), and a joint federal-provincial contribution of \$30 million (\$20 million and \$10 million respectively) was made for the diversification of the Cape Breton economy (Tupper, 1978, p. 339). Finally, the federal government undertook to make good the annual deficit of the coal division in lieu of the previous system of providing subsidies on coal sales.

The outcome was the establishment of a single corporation named the Cape Breton Development Corporation (DEVCO); it had two divisions, a Coal Division and an Industrial Development Division. The Coal Division took over DOSCO's mining and ancillary operations. Its mandate was to reorganize and rehabilitate some of the existing coal-mining operations and to conduct future coal mining and related operations in the Sydney coalfield on a basis that was consistent with efficient mining practices (section 15, *DEVCO Act*). In fulfilling this mandate and in

drawing up its 1968 plan for the minister responsible — a revised plan was submitted in 1972 — the Corporation was to take into account the direction and number of employment opportunities provided by the Industrial Development Division. It was also to administer the pre-retirement leave plan, a plan aimed at reducing the coal-mining labour force as quickly as possible without occasioning undue social hardship. Pensions were granted to former employees, and pension or lump-sum payments were made to employees laid off before they had reached the expected retirement age (DEVCO, 1969, Appendix 1, p. 1).

The mandate of the Industrial Development Division was:

To promote and assist, either along or in conjunction with any person or the governments of Canada or of Nova Scotia or any agency of either of such governments, the financing and development of industry on the island of Cape Breton to provide employment outside the coal producing industry and to broaden the base of the economy of the Island (section 22, *DEVCO Act*).

DEVCO was given a large measure of freedom to attempt to fulfill these aims. It could make loans or grants, purchase, lease, and develop lands on the Island, and pursue any other activities that it judged conducive to the attainment of its objectives (section 23(1), *DEVCO Act*).

The federal government approved both DEVCO's 1968 and 1972 plans for the mines. It also approved DEVCO's proposal for an industrial development strategy in 1972, and it made substantial financial resources available to enable DEVCO to carry out its plans. These resources consisted of capital grants for large mine investments and \$6 million per year, after 1971, for development (George, 1981, p. 10).

POLICY IMPLEMENTATION

The Coal Division

On October 1, 1968, DEVCO submitted to the Governments of Canada and of Nova Scotia the overall plan for its future operations as required by section 17 of the Act. On March 30, 1968, DEVCO became the owner of four mines and sundry other assets connected with coal mining (DEVCO, 1969, Appendix 1, p. 2). On the basis of this plan, DEVCO followed Donald's suggestion and set out to reduce the number of employees in its mines to between 2,000 and 3,000 by 1973, from the figure of 6,278 on March 31, 1968. The exact employment figure was to depend on the success of DEVCO's Industrial Development Division and other enterprises in providing alternative employment. DEVCO also set a goal of reducing output from 3.1 million tons in 1967/68 to 2 million tons or less in 1973 (*ibid.*).

The program by which these objectives were to be met involved the following elements: no general hiring, normal attrition, a Pre-Retirement

Leave Plan, increased mechanization and productivity, better coordination of production and market demand, the closing of mines and a reduction in the number of operating faces, the development of the new Langan mine, the purchase of Sydney Steel's coke ovens, and decreased operating losses.

The Pre-Retirement Leave Plan was compulsory for employees over 60 years of age and voluntary for those between the ages of 55 and 59. A minimum of 15 years service was required for full entitlement, and over 98 percent of the men affected at the outset were in this category. Compassionate retirement was also provided to younger miners who were incapable of performing miner's work because of disabilities acquired while mining. The benefit levels were set at \$2,400 per annum for single men, and \$3,000 per annum for those with dependents, plus a 2 percent per annum (compounded) cost-of-living increase (DEVCO, 1969, Appendix 1, p. 3). Those on leave retained their right to Canada Pension Plan benefits, and the plan entitlements were calculated as earnings; they were free to take alternative employment, but half of monthly outside earnings over \$50 was applied to reduce benefits. At the time of the plan's inception, it was estimated that if all the employees in the 55 to 59 age group accepted early retirement, the work force would be reduced by over 1,500 persons (*ibid.*). The Pre-Retirement Leave Plan was terminated in March 1974, when it was no longer thought necessary to phase down employment. By the end of 1973, the number of former employees over the age of 65 receiving a pension from DEVCO was 1,782 (compared to 1,810 a year earlier), and the number receiving Pre-Retirement Leave benefits was 1,541 (compared to 1,598 a year earlier (DEVCO, 1974, p. 15).

To achieve production goals, output was reduced partly by reducing the labour force and partly by closing mines. Of the four mines DEVCO inherited, two were closed, and another was abandoned after a fire. DEVCO also sought to improve efficiency by encouraging the departure of older or disabled members of the labour force under the Pre-Retirement Leave Plan, the introduction of training courses for examiners and overmen, the expansion of apprenticeship training, the extension of training programs for new entrants to 14 weeks, the installation of a health service, the replacement of old mines with new ones, and large-scale renovation and mechanization (George, 1981, p. 15).

Assessment of the Coal Division's Policies The cessation of hiring and the Pre-Retirement Leave scheme reduced DEVCO's labour force to about 3,531 in 1973, a figure 15 percent higher than its target (DEVCO, 1974, p. 12). By contrast, output went down much further than planned, falling to 1.3 million tons in 1972 and only 1 million tons in 1973, about one-half of its target (*ibid.*, p. 8). This was partly accounted for by a fire in one of the mines (DEVCO, 1972, p. 12).

The higher-than-expected employment and lower-than-expected output resulted in lower efficiency levels (measured in terms of output per manshift (OMS)) than expected. DEVCO had planned that its OMS of 2.5 tons in 1968 would double by 1973. In fact, its OMS remained at only 2.5 tons in 1972 (George, 1981, p. 26).

The year 1974 saw the first significant changes in the coal division's policy. The oil crisis of 1973 and the expected increase in coal demand as an energy source resulted in a sharp reversal of policy; the recruitment ban was lifted, the Pre-Retirement Leave Plan terminated, and an expansion of output planned. At the end of the fiscal year 1978/79 only one of the old mines remained open, but two new mines were in production. Output remained below the level at which it had stood on DEVCO's take-over in 1979, but it had increased by two and a half times its 1973 level, to 2,600,000 tons (DEVCO, 1979, p. 6). Employment had also increased by 25 percent of its 1973 level to 4,300 (ibid., p. 13). After 1979, production remained relatively stable, amounting to 2,680,000 tons in 1980/81 and just less than 2,000,000 tons in 1981/82. (The decrease occurred because a strike had brought mining and related surface operations to a standstill for 12 weeks (DEVCO, 1981, p. 4).) Employment was up to 4,509 in coal mining and related activities as of 1981/82 (DEVCO, 1982, p. 12), and output per manshift had doubled the level prevailing during the years 1968 to 1973, reaching 5.1 tons by the 1978/79 fiscal year. This new level, which was comparable to OMS in deep coal mines abroad, was indeed as satisfactory as the target level initially set for 1973, but was attained six years later than anticipated and at an investment cost of \$100 million (George, 1981, p. 27). Once achieved, however, the target level was generally sustained, falling slightly to 4.6 tons per manshift in the 1979/80 fiscal year, but rising again to 5.2 tons per manshift in the 1980/81 fiscal year (DEVCO, 1981, p. 6).

Under section 19(1)(b) of the *Cape Breton Development Corporation Act*, the corporation was entitled to statutory grants from the Canadian government up to a maximum of \$25 million. These funds were earmarked for capital expenditures, and the financial statements in DEVCO's annual reports show that all these funds had been received by the corporation by the end of the 1971 fiscal year. After that time, the capital expenditures of the Coal Division were financed by way of Parliamentary votes. This form of financing, reflecting the changed direction of the Coal Division, amounted to \$375 million from 1972 to 1983 inclusive. An additional \$7 million was received by the Coal Division in the form of expropriated assets, bringing the total amount of financing for capital assets to \$407 million.

The other major form of subsidies from the federal government included the financing of mining losses, which amounted to \$323 million over the 1968 to 1983 period, and \$20 million for the acquisition and development of the Prince Mine. Finally, \$800,000 in pre-retirement

leave for employees had been paid by the federal government in 1977, before the program's termination. In all, the total of funds received by the Coal Division amounted to \$751 million in the 1968 to 1983 period.¹² Losses on mining operations in 1984/85 have amounted to approximately \$50 million per year.

Industrial Development Division

The history of DEVCO's approach to industrial development can be subdivided into four phases: 1968–71, 1972–76, 1977–79, and 1980 to date. While the first phase is markedly different from all of the others, the last three phases differ only in their emphasis.

Phase 1: 1968–71 In its 1968 annual report, DEVCO explained its approach as making "the most efficient use of all resources of Cape Breton, including the location and the natural beauty of the Island." As this was by definition a long-term policy, it was seen as necessary in the short run to "attract secondary manufacturing industries and build up service industries in order to provide the new jobs needed . . . because Cape Breton Island [had] been so dependent on a few industries which have been in existence a long time" (DEVCO, 1968, p. 1). At the end of the four-year period it was estimated that between 25 and 30 business operations had opened in Cape Breton (George, 1981, p. 17). The instruments used to attract these firms were grants amounting to about \$7.3 million, loans totalling about \$13 million, loan guarantees and the provision of equity (ibid.). DEVCO also made a direct investment in a Sydney hotel to upgrade Sydney's tourist and convention facilities, in the building of an apartment complex to accommodate new DEVCO staff and other technical managerial personnel attracted to the island with new industry, and in a new industrial park at an abandoned Port Edward naval base.

In this period DEVCO also assisted its major purchaser on the island, the provincially-owned Sydney Steel Corporation (SYSCO). SYSCO is the provincial Crown corporation created by the Nova Scotia government to take over the Sydney Steel Mill from DOSCO in 1968. Because SYSCO was short of working capital, DEVCO purchased SYSCO's decrepit coke ovens, renovated them and ran them for five years. During these years DEVCO sold coke to the steel plant at low prices. In all, these actions amounted to a subsidy of approximately \$35 million from DEVCO to SYSCO (George, 1981, p. 18). However, a \$10 million charge levied by SYSCO on DEVCO for DEVCO's failure to provide its contracted supply when the coke ovens periodically broke down led to a change in DEVCO policy toward SYSCO in the second phase, when DEVCO required SYSCO to purchase back the coke ovens as a condition for a loan guarantee. By 1980, DEVCO had been largely replaced by the

federal and Nova Scotia governments as sources of direct and indirect financial aid to SYSCO.

Phase II: 1972–76 As explained in DEVCO's 1972 annual report (sixth), the industrial development division would attempt, in this phase, to diversify its efforts: rather than seeking to attract only branch plants of large firms, it would try to attract outside industry by first developing Cape Breton's own resources (DEVCO, 1973, p. 6). It was hoped that in this way, individual developments would complement one another; that exploiting the unique resources of Cape Breton would furnish a lever for establishing a market presence for specialty Cape Breton products; that promoting tourism would stimulate the economy directly, as well as promote domestic products; that in the long run, outside industries would primarily be attracted by factors other than mere financial hand-outs; that local or "grass roots" entrepreneurship would develop. Some of the potential growth areas were seen as tourism, manufacturing of distinctive products (furniture, pleasure boats, woollen goods and jam), and high-quality foods (oysters and lamb) (*ibid.*, p. 7). In order to ensure the viability of the various projects, each project was to be evaluated by an elaborate system of financial and cost-benefit analyses before it was implemented.

Central to these analyses was the question of whether or not the direct and indirect effects of any given project would raise incomes in Cape Breton on a permanent basis. The feasibility studies on the projects examined such considerations as the practicality of production methods, the availability of materials and manpower, the competence of management, the accuracy of market projections, the adequacy of the capital structure and cash flow, and the viability of revenue-earning projects within a reasonable time frame (George, 1981, p. 19). When such conditions as these were satisfied, the important question of how far DEVCO's involvement in the project was needed in order for the project to proceed and sustain itself was assessed, and a cost-benefit analysis was undertaken. The cost-benefit analysis would first examine expected, continuing, direct-income increases and then examine whether the benefit-cost ratio of the direct effects was greater than or equal to one. It would then assess likely indirect effects such as who would receive the increased incomes, and what other costs or cost savings would result for public authorities other than DEVCO. It would review probable effects in other parts of Canada and investigate what other environmental or developmental effects might be generated by the project. Indirect benefits were calculated as equalling at least 50 percent of the direct benefits, and it was assumed that for every full-time job created from sales outside Cape Breton, one-half a job is created from additional local transactions (DEVCO, 1974, p. 46).

To achieve these developmental goals DEVCO was organized so that it

could play different entrepreneurial roles appropriate to different cases. At one extreme it could act as an investment banker, making loans to businesses that were either too risky or too small to attract other lenders. At the other extreme, it could invest directly in business itself. This latter type of involvement was more likely to occur in enterprises such as trout fishing, where a large amount of research and development was needed, or in businesses such as the Cape Breton Steam Railway, where an operation was not profitable standing alone, but could be added to the corporation's existing operations at low marginal cost and yield significant public benefits as a tourist attraction (DEVCO, 1974, p. 25). Other forms of DEVCO participation in this phase tended to fall between these two extremes, taking such forms as responsibility for operational initiatives in such a way that producer cooperatives could eventually replace DEVCO (as in oyster cultivation), or granting assistance to non-profit organizations that were economic assets (such as a miners' village and museum at Glace Bay and information services) (*ibid.*, p. 26).

DEVCO's objectives and actions led to a great number and variety of projects being undertaken on the island. Below is a sample list of the type of activities undertaken by DEVCO after 1972:

Primary Industry:	oyster and trout farming, fishing, sheep importation and farming, beef farming, maple-syrup production;
Secondary Industry:	industrial parks, boat building, modular homes, wool milling, tanning (sheepskin), metal casting, lumber milling, sash and door manufacture, food processing (mostly fish), a variety of craft and other small operations;
Tourism:	attractions (steam railway, golf course, demonstration mine and miners' village, marinas, beaches), restaurants, accommodation, information services.

Of DEVCO's development funds expended in this period, secondary industry accounted for the largest share, then primary industry, then tourism (George, 1981, p. 22). SYSCO also received a guaranteed loan of \$70 million to help finance re-equipment, but it had to buy back the coke ovens from DEVCO as a condition. By March 31, 1974, the economic effect of the projects initiated under the development programs of 1972 was claimed to be 2,800 full-time jobs (DEVCO, 1975, p. 3).

Policy makers believed, however, that a more secure economy for Cape Breton could not be achieved without modernization and expansion of the area's other main employment source, the steel industry. The prospects for the steel industry were very much affected by the 1974

Cansteel study initiated by the Department of Regional Economic Expansion. DEVCO sought to show that potential investors in a major steel plant need not go far from the Sydney coalfield if they preferred a greenfield site to the existing Sydney location, because Cape Gabarus offered the same potential as other new deep-water locations (DEVCO, 1975, p. 4). In its turn, the Government of Nova Scotia, as owner of the Sydney plant (SYSCO), took advantage of the Cansteel results which essentially married the idea of producing "crude" steel in a world-scale plant with the creation of efficient facilities for more efficient steel production at Sydney (*ibid.*).

Phase III: 1977–79 In this phase the general policies of Phase II were continued, but less emphasis was placed on DEVCO's role as an entrepreneur in initiating enterprises, and more emphasis was placed on the supporting of "grass-roots" initiatives and enterprises.

In accordance with this changed emphasis, DEVCO made available loans and other aid to both primary and secondary industry. In primary industry, loans were made available for farm equipment, limespreaders were loaned out, beef and stock were upgraded, more ewes and rams were imported, inshore fishermen were assisted to obtain gear and nets, experiments were undertaken for a new fish trap, and DEVCO moved into the marketing of trout and provided facilities for fish plants to process more fresh and fresh-frozen products. In secondary industry, assistance was provided to specialized printing, scale repairs, cottage-craft manufacturing and knitting, hooking and pottery, ice-making facilities, leather crafts, furniture building, sawmills, wood products and fish processing (Payn, 1978, pp. 34–35). Similarly, in its tourism thrust, DEVCO focussed on making tourism more attractive: tourists could choose from a variety of types of accommodation from bed-and-breakfast operations to luxury inns and could spend the day in such activities as fishing, touring old mining sites, golfing or eating at chowder restaurants (Payn, 1977, p. 8).

By the start of Phase III, SYSCO's Cansteel project had yet to be implemented. Early in 1978, however, SYSCO's close cooperation with the federal and provincial governments resulted in the signing of an agreement by the federal Department of Regional Economic Expansion (DREE) and the provincial Department of Development that provided \$18 million (80 percent of which was provided by the federal government and 20 percent by the Nova Scotia government) for renewal work in SYSCO's production departments, for reactivation of the caster, for completion of new docking facilities, and for the erection of a 45-ton capacity dockside crane (Payn, 1978, p. 35). Notwithstanding these subventions, by 1980, the situation at SYSCO had deteriorated so badly that the provincial government accepted SYSCO's president's proposal that provincial and federal governments assume responsibility for the Crown

corporation's \$264 million debt load and provide a further \$45 million grant for expansion and refurbishing of the plant's caster and blast furnace (Payn, 1980, p. 12). SYSCO also called for implementation of the federal government's pre-election promise of a \$50 million investment in the aging plant and federal payment of the \$74 million interest on SYSCO's debt, stating that it would otherwise lay off some 800 men (*ibid.*). Although some negotiations to sell the plant had been initiated, no purchaser was interested until the massive debt was repaid. The province added force to SYSCO's demands on the federal government by calling for a restructuring of SYSCO's \$270 million debt and by making a \$12 million provincial grant to SYSCO, conditional on Ottawa making good its \$50 million promise under the DREE cost-sharing agreement (*ibid.*, p. 13). The election, in 1980, of three Liberal MPs from Cape Breton, including the re-election of Alan MacEachen, a long-time senior cabinet minister, continued to ensure a sympathetic hearing for both SYSCO's and DEVCO's demands in Ottawa. Whatever the future of SYSCO, it became clear that DEVCO was no longer central to SYSCO's survival.

Phase IV: 1980 to Present The start of this phase was coincident with a change of president for DEVCO. Although it is not stated explicitly in DEVCO's annual reports, assistance to secondary industry seems to be a current priority. In the 1980/81 fiscal year, 82 offers of financial assistance resulted from over 100 business proposals to the sum of \$1.3 million, a 66 percent increase over the 1970–80 fiscal period (DEVCO, 1982, p. 16). Similarly, the 1981/82 fiscal year saw 87 financial offers, which were expected to result in 220 person-years of employment (DEVCO, 1982, p. 16). The type of industry encouraged was the same in both fiscal years, consisting of the manufacture of mining equipment, primary and secondary wood products, crafts and food processing. Aid continued to be provided to farmers and fishermen, despite the decline in the economic health of fisheries generally, and renewed emphasis was placed on studying the development of other minerals and oil and gas, especially offshore petroleum (*ibid.*, p. 8). The development of both Sydport Industrial Park (an "international trade zone") and of the tourism program continued.

Finally, in this latest phase, a contraction of operations at SYSCO was begun. It was hoped that the phase-down would allow SYSCO to accelerate work on the various projects outlined in the federal-provincial agreement. Coke-oven operations have, in fact, been continuing, and essential services have been maintained. By 1983, the federal and provincial governments had agreed on a \$96.2 million capital-improvement plan in an attempt to secure basic operations and to reduce and eventually eliminate operating losses (Payn, 1983, p. 12). The future of SYSCO remained out of DEVCO's hands and in the hands of the two governments.

Assessment of the Industrial Development Division's Policies DEVCO's performance in the first phase of industrial development appears to have been largely a failure. Professor George takes the view that DEVCO's expenditure of \$30 million on industrial development was high relative to the number of jobs created in this phase (George, 1981, p. 29).

DEVCO undertook an evaluative study which covered most of the second phase, that is, its second five-year plan (1973–78). Although it acknowledged the difficulties of evaluating such a program, it claimed that at a conservative estimate, 2,100 person-years of employment were created (George, 1981, p. 29). Given the formula mentioned for indirect employment at 50 percent of this number, the total employment effect would equal approximately 3,000 person-years. Again, the usefulness of including this indirect effect is challenged by George, who claims that continued mining activities also would have supported this employment. George also translates these person-year estimates into the direct creation of perhaps 100 permanent full-time jobs (*ibid.*, p. 30). This achievement is small compared with initial expectations, although the reversal in DEVCO's coal policy in the early 1970s was a significant factor. DEVCO's decision, in 1972, to expand employment in coal mining rather than to contract it reduced the task of the Industrial Development Division of making good jobs lost in the Coal Division.

DEVCO's involvement with other governmental departments and agencies has not, on the whole, been very extensive. In all, the Nova Scotia government has adopted a relatively detached attitude to DEVCO since its establishment. Aside from taking over the Sydney Steel Mill from DOSCO in 1968, it has done little other than provide an interest subsidy to Nova Scotia Forest Industries and a loan to a fisheries plant, at least until quite recently. Cooperation with the province has accelerated in recent years as emphasis has been renewed on coal in power generation and the Nova Scotia Power Corporation has been established. Nova Scotia Power Corporation is now DEVCO's largest customer (Rankin, 1982). An area of disagreement appears to relate to the price of coal sold to the Power Corporation. Under a federal-provincial agreement, DEVCO sells most of its production to the Nova Scotia Power Corporation and to SYSCO at about half of the price of the cheapest overseas import (Surette, 1982, p. 10).

In the evaluation of the effectiveness of the Industrial Development Division's programs, a central issue is their cost. The federal government and the government of Nova Scotia agreed, on June 13, 1967 to provide the corporation with \$20 million and \$10 million respectively for industrial development purposes. All funds due under this agreement had been received by the end of the 1972 fiscal year.

The annual reports of DEVCO show that further federal government funding, by way of votes of the Parliament of Canada, amounted to \$75,993,000 in the years 1973 to 1983 inclusive.¹³ The minimum estimate

of funds received by the industrial development division from both levels of government over the 1967 to 1983 period is \$106 million.

It is difficult to judge whether or not the activities of DEVCO have justified their cost. Few, if any, of its direct enterprises have yet proved commercially viable, although certain motels, golf courses and other tourist attractions are expected eventually to pay their own way. Nova Scotia's tourism industry has expanded sharply with the decline in value of the Canadian dollar. Furthermore, most of the direct investments were intended to be ancillary devices to support tourism, fishing and agriculture and were not expected to be commercially viable in themselves. A number of DEVCO's unprofitable commercial ventures, including the sheep and fish-farming projects, have recently been abandoned. Where DEVCO provided assistance to private enterprises, the majority of those enterprises established since 1972 are still in operation.

CONCLUSIONS

The formation of the Cape Breton Development Corporation in 1967 was predicated on the recommendation of the Donald Commission in 1965 that coal-mining in Cape Breton be largely phased out by 1981. In the first few years of DEVCO's mandate, significant steps were taken in this direction, with reductions in productive capacity and related reductions in the size of the work force, facilitated by early retirement schemes. The rise in coal prices following the formation of the Organization of Petroleum Exporting Countries (OPEC) in 1973 led to a sharp reversal in this policy; major new capital investment was made in coal-mining and the work force grew. While the Donald Commission forecast very modest new capital appropriations by government, in fact, since 1967, over \$400 million in capital expenditures have been underwritten by the federal government, in addition to more than \$300 million in operating losses in mining. These operating losses have been incurred in every year since DEVCO's formation, despite increases in coal prices. Apart from these subsidies to coal mining, an estimated \$106 million has been provided by way of subsidies to development projects sponsored by the Industrial Development Division. Federal subsidies to the Cape Breton coal-mining industry from 1930 to the present day amount to well in excess of \$1 billion in nominal terms and much more in real terms.

Over all, the Industrial Development Division appears to have had a relatively modest effect on the creation of alternative sources of employment in the region, and substantial capital and operating expenditures will require continuing subsidy if the coal-mining industry is to be sustained. Employment at 4,500 in the coal division is not substantially lower than the level of 6,000 that prevailed at the time of DEVCO's take-over. Coal output today is almost as high as it was at the time of the take-over.

Thus the picture that currently emerges is one of an industry that is not

remotely self-sustaining, that will require further massive public subventions, and that has made very little progress toward the adjustment objectives defined by the Donald Commission and apparently contemplated for DEVCO in its initial mandate. Cape Breton's dependence on coal mining, 17 years after the creation of DEVCO, is almost as great as it was in 1967. Very little significant adjustment has occurred.

The vast proportion of subsidies allocated to DEVCO have been devoted to sustaining or even increasing coal-mining production and employment. A much more modest proportion has been spent in attempting to foster more diversified employment opportunities in the region, and a relatively trifling amount on labour-adjustment programs to facilitate re-employment in other sectors or regions. Substantial new entry into the work force since 1967 has caused the initial adjustment problem simply to regenerate itself. The extent of the adjustment problem is almost as great today as it was 17 years ago, despite the public expenditure of almost a billion dollars (in nominal terms). The regionally concentrated nature of the activities in question, the lack of ready, alternative, local job opportunities, the indirect dependency effects for affected communities, a highly organized work force, and influential political representation in Ottawa have combined to thwart the realization of any substantial adjustment goals.



The U.S. Policy Approach to Declining Industrial Sectors

The Policy-Making Process

In the United States, government has responded to declining sectors on an ad hoc basis, rather than within a general policy framework. "Government willingness to come to an industry's aid [has been] conditional upon the political and economic implications of the individual crisis" (Dyson and Wilks, 1983b, p. 97). One explanation for this ad hoc approach is America's liberal tradition that perpetuates an individualist political economic culture and is antithetic to widespread socialization of economic risk. Another explanation is the decentralized and fragmented nature of the political system. The separation of powers at the federal level, competing executive agencies, and the division of powers among the federal, state and local levels of government works to fragment the formation of industrial policy. There is little impetus to give up power to a central industrial policy agency such as Japan's Ministry of International Trade and Industry. The many agencies, committees and subcommittees within Congress and the Senate create competing bases of power and promote rivalries. Moreover, dispersion of responsibility within the American bureaucracy discourages a systematic approach to declining sectors.

American business, especially larger firms with the resources to maintain lobbying staffs or mount campaigns, find the American policy-making process open and accessible. There are no major formal consultative linkages between business and government, however, because of the institutional fragmentation within government and the lack of a "peak" business federation. The development of broad, integrative strategies, therefore, is discouraged; instead, narrow demands for

assistance are met by ad hoc responses. Labour also lacks a strong "peak" organization that could mould consensus. Moreover, labour is relatively weak in the United States: a much smaller percentage of workers are unionized than in Western Europe or Japan. Labour has often allied its interests with business in seeking assistance from government.

The American financial system, characterized by decentralization and a strong securities market, tends to concentrate power and decision making within the corporation itself; neither equity ownership nor long-term loans offer banks or the government opportunities to exert a major influence on industrial adjustment (Zysman, 1983, p. 269). Moreover the financial system is not closely integrated with the government; government intervention to regulate banks and control money supply has not disrupted the market character of the financial system, and the complicated and divided regulatory structure acts to insulate the system from executive influence (*ibid.*, p. 271).

General Programs

Background to Trade-Adjustment Assistance

The *Trade Agreements Act* of 1934 formalized the concept of "injury," in that the liberalization of trade would be abandoned if it involved undue economic injury to American firms or labour groups. This concept was modified eventually so that trade liberalization came to be taken as a given, but its costs were to be reduced through the *Trade Expansion Act* of 1962, which included programs to assist workers in firms injured by, or threatened with injury from, import competition. Before the *Trade Expansion Act* was passed, the only assistance available to workers of firms injured by import competition was the "escape clause" provision of U.S. trade legislation, a provision which was also endorsed in Article XIX of the General Agreement on Tariffs and Trade (GATT). Under this clause, governments could "escape" from trade concessions that caused undue injury by restoring previous trade barriers in the form of tariff protection or quantitative restrictions, or acceptable substitutes. In a 1947 executive order issued by President Truman, escape clauses became an established part of U.S. trade agreements. They proved, however, to be an infeasible policy instrument because they provoked retaliation from trading partners and because of the industry-wide effect of the provision in circumstances which required assistance to only a few firms and workers. Such clauses proved, moreover, to have minimal utility as an adjustment mechanism, since they served only to protect a declining sector and not to encourage retraining of human capital or retooling of physical capital.

Dissatisfaction with the escape clause prompted pressure to find an alternative. In 1954, the Randall Commission Report on foreign eco-

conomic policy included a proposal by David MacDonald, President of the United Steelworkers of America. The proposal called for extended unemployment compensation, and retraining and relocation benefits for workers (Frank, 1977, p. 3). Debate on adjustment assistance continued in Congress throughout the decade until, in 1962, the Kennedy administration added support to the concept by including a program on adjustment assistance in the *Trade Expansion Act*. President Kennedy was willing to consider the program a trade-off for significant multilateral tariff cuts to ensure U.S. access to the European Common Market (Richardson, 1982, p. 325). To gain the same commitment from the nations of the European Community (EC), President Kennedy proposed tightening the criteria for escape-clause relief to reassure the EC of the permanence of U.S. concessions. To gain congressional authority for substantial tariff cuts, he proposed trade-adjustment assistance as the preferable way of relieving any injury to interests within the United States. This trade-off between Congress and the executive was made necessary by certain characteristics of the American political process.

The Policy Process Surrounding Trade-Adjustment Assistance

Because power is fragmented and decentralized in the American political system (Krasner, 1978, p. 53), interest groups are able to exploit a large number of points of entry into the political system. The fundamental objective of U.S. policy makers has been to create a liberal international economic regime in which barriers to the free movement of goods, services, capital and technology would be minimized. Private groups, however, such as industry and labour, have some political ability to counteract or stall policy initiatives to this end. Thus the trade-adjustment assistance provisions of the 1962 *Trade Expansion Act* (TEA) have been characterized as a "bribe" to pay off the losers from trade liberalization. Katzenstein (1978b, p. 11) argues that the domestic political structure and its institutions, such as interest groups and business and labour organizations, are increasingly important determinants of foreign economic policy.

The compensatory provisions of the *Trade Expansion Act* of 1962 were liberalized under the *Trade Act* of 1974. The 1962 *Trade Expansion Act* had been largely unsuccessful as an instrument of assistance, with the result that bitter labour groups had termed the program "burial insurance," and the American Federation of Labor-Congress of Industrial Organizations (AFL-CIO) attacked it as a cruel and deceptive attempt to buy labour support for liberal trade policies (Frank, 1977, p. 4). The administration of the TEA was cumbersome and slow, and strict eligibility criteria were interpreted narrowly by the Tariff Commission. Benefits were received only following extremely lengthy delays, and their levels were inadequate. From 1962 to 1974, of 122,450 workers who filed 284

petitions, only 54,000 workers were certified in 29 states, involving a total outlay of \$85 million (United States, 1977a, p. 13). Only 39 firms were certified for assistance, and 16 adjustment proposals approved, to a total expenditure of \$32.5 million (*ibid.*). The major proportion of assistance to workers was in the nature of a readjustment allowance (a wage subsidy). Firms were assisted mainly by low-interest loans and loan guarantees.

By the early 1970s organized labour was becoming more protectionist, and in 1971, the AFL-CIO (1971) published a report which supported the highly protectionist Burke-Hartke legislation introduced in Congress in September 1971 in the House. Senator Vance Hartke and Congressman James A. Burke proposed a restrictive Foreign Trade and Investment Act, which provided for quantitative restrictions on imports and was intended to discourage foreign direct investment by American corporations. AFL-CIO President George Meany was an outspoken supporter of the bill, which was not enacted. Extensive hearings on adjustment assistance were held in 1972 before the Subcommittee on Foreign Economic Policy of the House Committee on Foreign Affairs. In 1973, the Nixon administration responded to the tenor of the hearings by liberalizing the administration of the eligibility criteria of the TEA adjustment-assistance program. In 1974, the *Trade Act* was passed, which formally broadened eligibility "as a sweetener to gain political support for American initiatives in the Tokyo Round" (Richardson, 1984, p. 5). The improved benefit levels and eligibility criteria were intended to defuse political support for the protectionist alternative. Most analysts have found the program ineffective in promoting adjustment objectives. In 1981, the Reagan administration drastically cut income-support benefits and retightened eligibility requirements. The United Auto Workers (UAW) has since brought at least three suits against the U.S. Department of Labor to force it to carry out expenditures of even its greatly reduced budget commitments.¹ It remains to be seen whether the curtailment of the program will result in renewed pressure for protectionism, which the program was intended to reduce.

Administration and Effects of the Trade Expansion Act, 1962

LABOUR AND THE TRADE EXPANSION ACT

From 1962 to 1974, strict and cumbersome eligibility criteria effectively neutralized the TEA program. Under the TEA, a causal connection had to be found between an increase in imports and trade concessions which would establish that the increase in imports was the major factor in the injury which had occurred. The Tariff Commission interpreted "major" to mean that imports were a more important factor than any others combined in causing injury, and that tariff concessions and injury must

have occurred simultaneously. This situation was extremely difficult to prove, and the process of determination was costly and time consuming. Workers could choose between application to the Tariff Commission or to the Secretary of Labor *after* the Tariff Commission had found an injury and the President had authorized eligibility for adjustment assistance (Rosenblatt, 1977, p. 1069). In practice, applications for certifications of eligibility involved duplication of steps, as well as the required submission of information that was both difficult and expensive to provide (Frank, 1977, pp. 40–44). In addition, the Commission was lax in meeting its time limit for processing applications. Perhaps because of these impediments, a limited number of petitions was received. Low benefit levels were another deterrent to the use of the program.

A worker who applied for trade-adjustment assistance must have been employed for at least 78 of the 156 weeks before application and have been employed in an adversely affected firm for at least 26 of the preceding 52 weeks prior to the beginning of his/her unemployment period. Once a worker was declared eligible, he or she could receive allowances during the two-year period following the acceptance date. The maximum benefit period was 52 weeks. Additional allowances could be granted if the worker was over 60 or enrolled in a training program certified by the Secretary of Labor. In both instances the benefit period could be extended by 26 weeks.

The readjustment allowance of the adjustment-assistance program was a direct wage subsidy to the worker which amounted to 65 percent of the worker's average weekly wage when employed in her or his last place of employment or 65 percent of the average weekly manufacturing wage, whichever was less. Payments were non-taxable, but were reduced by any amounts received under the *Manpower Development and Training Act*, and by 50 percent of each dollar earned in any manner. A relocation allowance was granted to the family head to defray all reasonable expenses incurred in moving, in addition to a lump-sum payment equal to 250 percent of the average weekly manufacturing wage.

From 1962 to 1969, not a single worker was certified as eligible for assistance. Applications and certifications increased, however, following a change in the Tariff Commission membership, less rigid interpretations of criteria, and tariff cuts instituted at the Kennedy Round (Rosenblatt, 1977, p. 1071). From 1969 to April 1975, when the TEA was replaced by the *Trade Act* of 1974, 110 petitions from worker groups were certified, covering 54,000 workers, although only 35,000 received benefits (Frank, 1977, p. 53). Payments to workers totalled \$89 million, primarily in the form of wage subsidies (*ibid.*). The personnel and employment-service aspects of the program were used to a minimal extent, that is, by only 10 percent of all assisted workers. Many workers did not apply for retraining, since no specific programs were established to aid those in industries affected by trade.

The cautious approach of the program was undoubtedly related to the novelty of the concept of trade-adjustment assistance (Frank, 1977, p. 53). The ideological issue of government intervention in the economic adjustment process and concerns about the potential for program abuse no doubt contributed to the caution exercised in its administration.

CAPITAL AND THE TRADE EXPANSION ACT

The TEA program as addressed to capital was a direct substitute for import barriers in that an industry had to qualify for escape-clause relief before applying for adjustment assistance; such assistance would then be used as an alternative to the reinstatement of tariffs or quotas. Certification of eligibility was granted to a firm through Tariff Commission findings of injury. It was the result either of industry petitions for escape-clause relief or of firm petitions for adjustment assistance. The eligibility criteria for firms were the same as those for labour. Firms could receive both financial assistance and technical assistance such as consulting services to provide market research, managerial and financial advice, and help with research and development. Among the instruments employed were loan guarantees to 90 percent of principal, low-interest or extended-maturity direct loans, and tax relief in the form of carry-back of net operating losses to the five taxable years, rather than the usual three, preceding the year of the loss incurred as a result of import competition. The program was highly unsuccessful in dealing with firms. Certification, as in the case of labour, often involved duplication of effort. Firms could apply directly to the Tariff Commission or to the Secretary of Commerce, but application to the Department of Commerce was possible only after the Tariff Commission had found injury and the President had authorized eligibility (Rosenblatt, 1977, p. 1070). As with labour, the cumbersome nature of the program limited its effects.

From 1962 to 1969, no firms were certified for assistance. From 1969 to April 1975, however, because of the same changes that had affected labour, 36 firms were certified by the Department of Commerce; 19 of these actually received assistance totalling \$41 million (Frank, 1977, pp. 49–52). The strict eligibility criteria often disqualified troubled firms, and private lenders were unwilling to take the risk of helping the most distressed firms which did qualify, because of the 10 percent of the loan which was guaranteed.

The industries which received most assistance were footwear, textiles, and pianos. The last-named industry was one in which all firms could apply by virtue of the approval of an escape clause for the industry (Frank, 1975, p. 229).

Administration and Effects of Title II of the Trade Act, 1974

WORKER-ADJUSTMENT ASSISTANCE UNDER THE TRADE ACT, 1974

Trade-adjustment assistance (TAA) became more attractive under the *Trade Act* of 1974 as the program's benefits were increased and eligibility criteria loosened in a political response to the growing protectionist sentiments of organized labour. The intended object of the TAA was not achieved, however, as the program continued to be more an instrument to compensate labour and firms for injury resulting from competition than an instrument to promote adjustment of labour and capital, either within sectors or out of declining sectors.

The criteria for eligibility were liberalized with the result that the Secretary of Labor (who assumed responsibility from the Tariff Commission for decisions on worker applications) must consider whether a significant number or proportion of workers (50 employees or 5 percent of the work force) in a firm or in one of its subdivisions are unemployed or threatened with unemployment; whether either sales or production or both have decreased; and whether increased imports like, or directly competitive with, articles produced by the worker's firm or subdivision contributed "importantly" (and, therefore, not more importantly than any other factor) to the situation mentioned above (Rosenblatt, 1977, p. 1072). The Secretary of Labor need not consider whether there is a causal link between an absolute increase in the level of imports and previous U.S. trade concessions. Decisions on certification must be issued not later than 60 days after the petition is filed, a deadline which replaces the eight-month limit within which the Tariff Commission worked under the TEA. Once a worker is certified as eligible for trade-adjustment assistance (TAA) benefits, that eligibility is activated automatically for all layoffs covered by the petition in the subsequent two years. The state employment-security office must approve the application for benefits of an individual worker covered by certification.

Benefits under TAA have improved: a worker's potential income support from TAA supplements has risen to 70 percent of previous weekly wages, but cannot exceed the average weekly manufacturing wage. Benefits are reduced by 50 percent of any earnings and by the amount of any unemployment insurance received or to which the worker is entitled. The total amount of income subsidization cannot exceed the lesser of 80 percent of the worker's average weekly wage or 130 percent of the average weekly manufacturing wage. The transfer payments are made from a general operation fund which does not depend on worker or employer contributions, but is funded from the Department of Labor's budget allocations. Benefits are provided for up to a maximum of

52 weeks. Workers over 60, however, and those in an approved training program may receive benefits for an additional 26 weeks.

Relocation allowances have been increased to reimburse 80 percent of the costs of moving the worker, his or her family and household effects, plus a lump-sum payment equal to three times the earner's weekly wage of up to \$500. Job-search allowances reimburse a worker by 80 percent of related expenses, up to \$500. Benefits also include training and related services such as testing, counselling, placement and support services.

EFFECT OF THE PROGRAM ON WORKERS

The TAA's compensation provisions have been much more widely used than have its economic-adjustment provisions. From April 1975 to July 31, 1977, 2,234 petitions were filed for worker assistance (Rosenblatt, 1977, p. 1073). Almost 40 percent were denied, 35 percent were approved, and the rest remained undecided, although some had been withdrawn or terminated. The majority of the 229,247 workers certified as eligible represented the fabricated metal products, primary metal, electrical equipment and supplies, apparel and leather industries. Worker interest and participation in the program was highest in Michigan and Pennsylvania (*ibid.*).

The program has functioned primarily as an income-subsidization program for those on temporary layoffs and likely to return to work with the employer who discharged them; two-thirds of all recipients returned to their former jobs, which suggests that the adjustment orientation of the program is minimal.² Approximately 95 percent of the benefits paid to and including July 31, 1977 have taken the form of trade-readjustment allowances.³ The readjustment allowance is a subsidy paid to the worker which acts as an instrument of compensation for the costs of adjustment. Thus, it appears that only 5 percent of the benefits paid have been used for the purpose of encouraging positive adjustment, such as the retraining of human capital. On average, unemployment insurance and TAA benefits replaced 76 percent of recipients' income (Richardson, 1982, p. 330). During this period the unemployment-insurance and trade-adjustment assistance allowances to 201,000 workers totalled \$275.2 million (Rosenblatt, 1977, p. 1072). By the end of 1978, 403,000 workers had received transfer payments totalling \$617 million, yet only 15,000 had received training under the program, only 2,000 had received job-search allowances, and only 1,200 had received relocation allowances (Ramseyer, 1981, p. 601). Of the 494,000 employees assisted under the program between April 1975 and September 1979, 75 percent returned to their former employers, 4 percent were placed in new jobs by the TAA, only 3.5 percent entered training, and fewer than 1 percent received job-search and relocation benefits (Quinn and Trebilcock, 1982, p. 138). Of those displaced workers who had exhausted their unemploy-

ment-insurance benefits, only 20 percent had received counselling, 8 percent job referrals, and 7 percent training (*ibid.*). One of every 300 TAA recipients took advantage of training services from April 1975 to December 1979, one of every 200 received a job-search allowance, and one of every 350 received a relocation allowance (Richardson, 1982, p. 330).

Of the workers who received benefits, 50 to 80 percent (depending on the industry) were back at work at their former jobs by the time they received them (United States, 1977a, p. 14). Most had returned to work, 134 days, on average, after they were discharged, but they did not receive benefits until 380 days following discharge. As a cross-industry average, the lag between separation and the first TAA payment was 14 months (Richardson, 1982, p. 331).

The TAA program has been used defensively, primarily as an instrument of symptomatic relief for injured workers. Much of the assistance has been paid to workers in cyclically depressed industries, such as autos and steel; fewer than one-half of all recipients were employed in industries (such as textiles, footwear, apparel) in which the United States may have lost its long-run comparative advantage (Quinn and Trebilcock, 1982, p. 138). Very little was accomplished in the way of helping workers to adjust either by enabling them to become more productive in their present occupations or by facilitating the transition of individuals to more promising employment in other industries (United States, 1977a, p. 14). The reasons for the program's emphasis on distributional, rather than economic, objectives are varied.

First, "like or directly competitive article" has been interpreted so narrowly that imported finished articles are not considered "like or directly competitive" to domestically produced components (United States, 1977, p. 14). The result is that workers in firms which produce component parts have been denied assistance. Service workers have also been denied assistance, since they do not produce "goods" in competition with imported "articles" (*ibid.*). The UAW and the AFL-CIO have argued for the need to broaden criteria to include workers in services or component-part production connected with an article facing import competition (*ibid.*). This would include assistance to workers such as those laid off by airlines as a result of competition from foreign airlines. Unions have been sensitive to the effect of imports on the stability of employment and, therefore, on union membership. There may be some institutional reluctance to pursue positive adjustment for fear that such action would erode union strength (Rosenblatt, 1977, p. 1075). Workers also have lacked motivation to pursue retraining and relocation, since unemployment has recently been a problem in many sectors. A major administrative and political issue (*ibid.*) has been federal-state conflict, since the states are responsible for delivering trade-readjustment allowances and training services, although all pro-

grams under the *Trade Act* are financed by the Department of Labor. Training and related services "are to be provided under existing federal manpower programmes through agreements with the states."⁴ There is no assurance for the states, however, that funds will be made available specifically to train import-affected workers. Fund allocations are made at the discretion of the Department of Labor, and in practice it has been difficult to provide adequate programs (*ibid.*, pp. 1080–83). State agencies are unwilling to differentiate among workers on the basis of the reasons for their unemployment, or to give priority to import-affected workers as compared with other workers seeking identical employment services (United States, 1977a, p. 16).

Studies conducted by the General Accounting Office (GAO) of the U.S. Controller-General have been critical of the Department of Labor's administration of the program.⁵ Non-union workers have made limited use of the program because they have lacked awareness of it. In the program's first 10 months, from April 1975 to January 1976, 80 percent of applicants were unionized (Rosenblatt, 1977, p. 1077). Although s. 223(a) of the *Trade Act* specifies that applications must be decided within 60 days, the GAO found that "during the first year of the program . . . only 25 percent of the petitions submitted were processed within this time. The remainder required from 61 to 185 days" (*ibid.*, p. 1078). The GAO concluded that one part of the problem was limited personnel, a number of whom had little or no formal training in the areas needed to make recommendations and decisions on applications; a second part of the problem was a heavier-than-anticipated workload (*ibid.*). The reports found a need to balance general rules to facilitate rapid processing with detailed knowledge of the characteristics of each situation (*ibid.*, p. 1079). Thus there is tension between promptness and the need for equitable treatment of individual cases.

ADJUSTMENT BY LABOUR UNDER THE TRADE ACT

Despite adjustment-retarding effects of the readjustment allowances to workers in the steel, textile, apparel and footwear industries, the labour force has made significant adjustment. Employment in the steel industry has declined from 624,764 workers in 1965, to 452,000 in 1977 (Peabody, 1979, p. 52). In the textile industry, the labour force declined from 1,106,868 workers in 1956, to 927,492 in 1966, to 883,161 in 1977 (Aggarwal and Haggard, 1983, p. 260). Thus, from 1955 to 1977, employment dropped by 22 percent (*ibid.*, p. 258). Contraction has also occurred within the footwear industry. Employment has fallen from 240,000 workers in 1966, to 160,000 in 1976 (Yoffie, 1983, p. 323). Within the principal producing states of Pennsylvania, Missouri, New York, Massachusetts, Tennessee, Maine, New Hampshire and Arkansas, employment in the footwear industry declined, on average, by 34.6 per-

cent from 1968 to 1976.⁶ New York and Massachusetts experienced declines in employment in the footwear industry of 48.3 percent and 51.8 percent respectively (*ibid.*, p. 325).

ADJUSTMENT ASSISTANCE TO FIRMS UNDER THE TRADE ACT, 1974

The eligibility criteria for firms applying for trade-adjustment assistance are the same as those for workers, except that the Secretary of Commerce is the responsible official. The Department of Commerce considers the operations of affiliates, subsidiaries and parents on a consolidated basis. The Economic Development Administration (EDA) has administrative responsibility for the firm and community aspects of the program.

Firms may receive technical assistance to help them prepare and implement economic adjustment proposals. Direct loans and loan guarantees may be used for the acquisition, construction, installation, modernization, development, conversion or expansion of buildings and other assets, and as working capital (Rosenblatt, 1977, p. 1084). Direct loans to any one firm may not exceed \$1 million; the lending rate is to be determined by the Secretary of the Treasury, who adds an amount to the lending rate "to cover administrative costs and probable losses under the program" (*ibid.*). The interest rate has generally been higher than the costs of direct loans under the Small Business Administration (SBA) Program and the *Public Works and Economic Development Act* (PWEDA) (*ibid.*). Both the high cost and low level of the loans may have acted as a disincentive to firms who might qualify for adjustment assistance.

The interest rate on loan guarantees, which have a \$3 million ceiling, is specified to be no higher than the rates established under the SBA (Rosenblatt, 1977, p. 1085). Ninety percent of the loan is guaranteed, and a fee of .25 percent of the non-guaranteed portion may be charged to the lender (*ibid.*, p. 1084).

Firms are also eligible for assistance under other programs of the EDA, such as those under the PWEDA, the SBA, and the Farmers Home Administration programs of the *Consolidated Farm and Rural Development Act*. However, assistance under the *Trade Act* may be more attractive to some, since *Trade Act* funds are not restricted to designated areas of high unemployment as are EDA funds (United States, 1977a, p. 27). Section 702 of the PWED, which prohibits loans and guarantees from being used to expand productive capacity in an industry found to have long-term overcapacity, does not apply to assistance under the *Trade Act*. The absence of this provision would appear to compromise the purposes of adjustment under the *Trade Act*. Firms may also receive assistance under the *Trade Act* programs if they are relocating; there is no provision for such assistance under the PWEDA.

There has been a low level of program activity with respect to assistance to firms. In 1978, the GAO estimated that over 14,000 manufacturing firms might have been hurt by imports.⁷ However, from the program's inception in April 1975 to August 30, 1977, 164 petitions had been received, 103 accepted, 18 withdrawn, terminated or denied, 73 certified, and 12 were pending (United States, 1977, p. 13). Of the 73 certified applications, 18 applications for financial assistance had been approved to a total of \$19 million, and seven were in process. The applicant firms were concentrated in the textile, apparel and footwear industries, and most were located in New York, Pennsylvania and Massachusetts (Rosenblatt, 1977, p. 1085).

Although the EDA appears to have been efficient in its administration of the program, problems have arisen. The high cost of the loans (9.25 to 9.5 percent) and of the loan guarantees (prime plus 2 to 3 percent) deters applicants and makes repayment difficult (Rosenblatt, 1977, p. 1086). Borrowers must provide personal and corporate guarantees of repayment, and there has been difficulty in obtaining commercial bank participation in the non-guaranteed 10 percent of the loan guarantee (*ibid.*, p. 1087). In addition, the limitation on loan amounts renders them of little value to larger firms. Many eligible firms are unaware of the program, and those which are aware of it face a contradictory and almost insurmountable requirement. They must demonstrate both that production or sales volume is decreasing *and* that "there is reasonable assurance" that they will be able to repay any loans received under the *Trade Act*.

Adjustment assistance to firms also has had a highly compensatory rather than an adjustment effect. Firms adversely affected by imports will likely be smaller, older or undercapitalized (Rosenblatt, 1977, p. 1088). Therefore they may be marginal operators even without import pressure. The *Trade Act* does not require firms to shift their investments to growth-oriented sectors, nor does it disqualify firms in industries with demonstrated long-term overcapacity. Most firms have used loans obtained under the program to maintain their marginally competitive operations rather than to restructure their businesses (Ramseyer, 1981, p. 602). By making financial assistance available at relatively high cost and in relatively limited amounts, the statute has tended to diminish the likelihood of firms making the necessary transition by upgrading productive efficiency in current product lines or by making the transition to other lines (Rosenblatt, 1977, p. 1088). On the other hand, the limited availability of assistance under the program has probably had a marginal effect on the muting of adjustment pressures.

ADJUSTMENT BY CAPITAL UNDER THE TRADE ACT

The steel industry has consistently argued for public assistance on the basis that it needs time to regain competitiveness and avoid layoffs

(Reich, 1983, p. 184). Firms within the steel industry, however, have diversified out of steel rather than reinvesting to modernize production processes. The United States Steel Company, the industry leader, has closed 13 steel-making and -fabricating facilities, while investing in a new shopping centre in Pittsburgh, Pennsylvania, and building chemical facilities in Houston, Texas. From 1976 to 1980, the company's non-steel assets grew by 80 percent, while steel assets grew by 13 percent (ibid.). Steel making now accounts for only 11 percent of the United States Steel Company's operating income.⁸ Firms in the textile and apparel industries have used public assistance to increase capital intensity, to merge, and to relocate in the southern United States in order to benefit from lower labour costs (Aggarwal and Haggard, 1983, p. 258).

ADJUSTMENT ASSISTANCE TO COMMUNITIES

A program of assistance to communities in trade-affected areas was implemented under the *Trade Act* of 1974. The community was eligible if

- there was significant unemployment or threatened unemployment;
- sales and/or production of firms in the community had declined; and
- increased imports or the transfer of firms located in the community to foreign countries contributed to an important extent to the first two criteria.

The certified community was required to establish a Trade Impacted Area Council for Adjustment Assistance composed of representatives from industry, labour, government and the general public. The Council was to develop an adjustment plan for the economic rejuvenation of the area. The community was then eligible for a full range of Enterprise Development Administration programs, except loan guarantees, under the *Public Works and Economic Development Act*.

No community has yet been certified (Rosenblatt, 1977, p. 1069). A community with a diversified local economy might find it difficult to prove that total employment has declined because of the adverse effects of imports on one of its industries, and firms not affected by imports might not be willing to reveal data on sales and production for evaluation (ibid.). Communities therefore have relied on regular EDA programs addressed to community-infrastructure development, such as those in the *Public Works and Economic Development Act*.

Evaluation of Trade-Adjustment Assistance

The trade-adjustment assistance program was intended to compensate the losers from the liberalization of trade policy as an alternative to increased tariffs or quota protection. However, the program has probably made the recipients of compensation, both workers and firms, less

willing to move out of declining sectors, even though such a move is the stated rationale of government policy. The TAA program has not acted to make it easier for the losers from shifts in market conditions to make more rapid adjustments to such shifts (Quinn and Trebilcock, 1982, p. 137). The efficiency-enhancing effects of the program appear to have been minimal.

Any distributional rationale for special treatment for those injured by trade liberalization is debatable. According to one study, those assisted generally have higher pre-displacement incomes than their counterparts in manufacturing industries generally, although they are somewhat older and less well educated. They are more stable in their employment history, more likely to be union members and the heads of households than the average unemployed worker (Richardson, 1982, p. 322). A second analysis has found that assisted workers have the characteristics of a secondary labour market: they are older, less skilled, and unable to find alternative employment (Frank, 1977, pp. 53–55).

TAA does not appear to have served as an effective political bribe to win support for trade liberalization. Provision of compensation to those injured by trade liberalization which benefits the general public was thought likely to reduce the political opposition of those injured. However, because of delays which make compensation uncertain at the time of displacement and because of insufficient compensation, which provides only for the loss of income while unemployed and not for permanently lost quasi-rents to owners of sector-specific human capital, the program has not been politically effective (Wolf, 1982, p. 366).

Assistance is also unlikely to aid firms in industries which have lost their comparative advantage, since the program rewards attempts to ensure survival rather than adjustment and exit from a declining sector. Nevertheless, TAA may have had an important effect as a signal to workers and firms that a plant or firm is under competitive pressure from imports (Richardson, 1984, p. 6). It may encourage adjustment by adding to the caution of workers and firms contemplating commitments in import-sensitive sectors. Moreover, its effect on import-affected industries has been so small that often there have been no significant changes in product prices or factor costs; layoffs continued, and competitive pressures from imports continued.⁹ While market signals to adjust may have been somewhat muted, Richardson claims that TAA may have reduced the incidence and duration of subsequent spells of unemployment for workers by increasing the efficiency of job search. With TAA compensation, workers were able to take the time to look for a “better matched” job (*ibid.*). Still, the fact remains that the vast majority returned to their previous employer.

In 1981, the Reagan administration undertook to cut spending on TAA from \$1.5 billion to \$350 million by 1982.¹⁰ Workers are eligible for TAA only after they have exhausted unemployment-insurance benefits, and

the entire jobless-benefit package will last a maximum of 52 weeks. Any worker recalled to work by her or his former employer will be ineligible for TAA following recall. Previously, the worker could receive unemployment benefits concurrently with trade-adjustment assistance for 52 weeks, with provisions for an extension of this period. A large number of workers continued to receive the assistance to which they had been entitled even after they had returned to work. The tightening of program conditions is an attempt to move away from compensation *per se*, and it has met vehement opposition from unions in the automobile, steel and rubber industries.

Sectoral Programs

The Steel Industry

BACKGROUND

Over the past 25 years, American steel producers have fallen from a position of world dominance in technology, plant scale and productivity, with comparative advantages based on a large home market, abundant raw materials and skilled labour, access to a large capital market, and benefits from innovation in other sectors of the economy. They have come to experience a decline in which large domestic producers retain their market share only with government assistance. U.S. steel production has not grown since the mid-1960s, and the American share of world steel production fell from 40 percent in 1955, to 18 percent in the early 1970s (Borrus, 1983, p. 69).

By the 1960s the industry had become a stable oligopoly led by the United States Steel Company, which set the pattern of industry-wide investment, production and prices. Government procurement and long-term labour contracts also contributed to stability. In the later 1950s and early 1960s, American steel-makers resisted the shift from open-hearth furnaces, in which they had invested heavily immediately following World War II, to newer technologies such as the basic oxygen furnaces and continuous casting. During this period the Japanese were investing heavily in new production processes. Today, over 80 percent of Japanese steel is being produced in the more efficient basic oxygen furnaces, compared to 64.7 percent of American steel; and 58 percent of Japanese steel is continuously cast compared to 17 percent of American steel (Borrus, 1983, p. 67). By 1980, Japanese steel producers had an absolute advantage over their American counterparts in labour, raw materials and capital costs, with a 40 percent average production-cost advantage over the largest American producers (*ibid.*, p. 74).

The first wave of low-priced steel arrived on the American market in the late 1960s, during a period of world oversupply in steel. Features of

the U.S. industry such as administered prices and guaranteed wage increases inhibited competitive flexibility. By 1969, steel imports claimed 9 percent of the American market (Borrus, 1983, p. 74). American producers reacted to the loss of market share with a strategy of "catch-up," but investment was directed to plant replacement instead of the construction of new integrated facilities (*ibid.*). Price increases out-paced inflation to sustain high dividends for equity investors and to generate internal funds for capital expenditure, since American banks were reluctant to finance an industry in trouble (*ibid.*). By the early 1970s, American producers had failed to narrow the Japanese cost advantage, import competition was severe by industry standards, environmental compliance costs were rising, and 35 percent of capacity was outmoded (*ibid.*). At this time the industry shifted its strategy to one of protection of the home market.

The 1970s formed a period of intense political activity on the part of the steel industry. A coalition of industry and labour was able to shift the policy debate from the problem of domestic competitive inefficiency to the issue of allegedly unfair foreign-trading practices. Producers acted to protect their domestic market and to insulate themselves from the need to restructure. Major steel producers did not invest in new plant and equipment during the "breathing space" following the imposition of voluntary restrictions on steel imports in 1969. From 1969 to 1975, the industry's capital expenditures were below the 1968 level, at a time when Japanese steel producers were increasing their assets by over 23 percent annually (Reich, 1983, p. 180). By 1977, steel production was stagnant, foreign steel had captured 16 percent of a shrinking market, and costs were rising by 10 percent per year (Dyson and Wilks, 1983b, p. 90). The industry — and a number of analysts — alleged that anti-pollution regulations placed a heavy burden on investment and diverted capital expenditure from retooling. This claim, however, is disputed by Reich, who has noted that although the U.S. steel industry spent an average of \$365 million annually to reduce pollution and improve worker safety (a sum which was 17 percent of average annual capital investment during the decade), 48 percent of the cost was subsidized by state and local governments through industrial development boards (Reich, 1983, p. 182). In the same period, Reich notes, the Japanese were spending twice the amount spent by American producers on compliance with environmental regulations. In 1979, the United States Steel Company entered into consent agreements with the Environmental Protection Agency to relax the time frame within which it was to meet environmental regulations. The company alleged that it needed the extra time to meet the pollution requirements, and would use that time to revitalize its operations in Pittsburgh. To date, no major investment has been made at the Pittsburgh plant (*ibid.*). Indeed, the company has been diversifying out of steel, which is, of course, an indication of an important form of

adjustment, although not the premise of the assistance provided to the industry. In 1981, American steel producers entered another period of dismal performance following two relatively profitable years. Imports increased by 30 percent from 1980, and domestic mills operated at 55 percent of capacity, with almost 22 percent of workers laid off (Borrus, 1983, p. 105).

GOVERNMENT INTERVENTION

During the 1950s, relations between the steel industry and the U.S. government were ambivalent (Borrus, 1983, p. 71). Following World War II, the steel industry purchased steel plants at a fraction of the cost at which the federal government had had them constructed during the war. That government also provided low-interest loans and accelerated depreciation for expansion in the 1950s. Through the 1950s and 1960s, the industry's pricing practices were watched closely by successive administrations, as steel price increases (which outpaced domestic inflation) were perceived as a major cause of inflation.

The industry's argument for protection has centred on an assumption of unfair competition through unfair trading practices. The industry has alleged that high, protected home-market prices in exporting countries have subsidized low export prices, and that these low prices have enabled foreign producers to capture a growing share of the American market by pricing their exports below average cost.¹¹ Foreign producers, therefore, "dump" steel on the American market, and American producers cannot meet the competition and remain in business. In essence, "fairness" has masked the inability of American producers to adjust structurally and avoids the issue of the competitive state of the American steel industry. According to Borrus (1983, p. 83), when the American steel industry "cast its argument into the typical ideological mold of U.S. trade policy, it acquired a powerful political tool to divert the policy debate over adjustment in steel to the major producers' own ends."

In the 1950s and 1960s, the "dumping" argument had not won complete acceptance. During this period steel was protected by tariffs which ranged from 6 percent to 8 percent of the value of imports (Crandall, 1981, p. 107). In 1968, the United States negotiated Voluntary Restraint Agreements with Japan and the European Coal and Steel Community to restrict imports into the United States of stainless steel, tool steel and other alloy steels. It also imposed restrictions on other suppliers, such as Sweden and Australia, which had refused to enter into voluntary restraint agreements (Steele, 1979, p. 34). The Agreements were intended to encourage adjustment by providing time for modernization. During the six-year Agreement period, however, capital expenditures were below the 1968 level (Borrus, 1983, p. 84). Following the termina-

tion of the Voluntary Restraint Agreements in 1975, the industry-union coalition pressed for separate steel negotiations within the framework of the Multilateral Trade Negotiations under the General Agreement on Tariffs and Trade (GATT). In the same year, the United States Steel Company filed seven anti-dumping petitions under the *Anti-dumping Act* of 1921¹² against six European Community (EC) producers and Australia. This action corresponded with an increase in domestic steel demand as the United States recovered from the recession, a demand which foreign producers keenly competed to satisfy.

In October 1977, the American Iron and Steel Institute filed a petition with the Special Trade Representative alleging that an EC-Japan bilateral agreement was unfairly diverting steel to the American market. United States Steel's Edgar Speer, chairman of the American Iron and Steel Institute, major producers, and the United Steel Workers of America were demanding "fair trade" and calling for protection using "national security" and "health of the economy" arguments (Borrus, 1983, p. 88). Pressure continued for separate sectoral negotiations at the Multilateral Trade Negotiations. However, Robert Strauss, President Carter's Special Trade Representative, was unwilling to jeopardize the overall negotiations. The U.S. Administration sought to avoid domestic protectionist actions while negotiating for trade concessions abroad. The Administration also wished to avoid the price increases which likely would result from protection. Pressure to act increased in late 1977, however, when 14 major steel mills were closed down, and 20,000 workers were laid off (*ibid.*, pp. 89–90). In September 1977, the bi-partisan Congressional Steel Caucus was formed; it consisted of members of Congress from the hardest-hit steel states and representatives of major producers and of the United Steel Workers. By early October, five major protectionist bills were introduced by members of the steel caucus (*ibid.*, p. 90).

In the same period the Treasury ruled that Japan had been "dumping" carbon-steel plate in the United States. This positive ruling opened a floodgate. By December 1977, the steel industry had filed 19 anti-dumping petitions (Reich, 1983, p. 177). The EC threat of retaliation put more pressure on the United States at the Multilateral Trade Negotiations. As a preliminary measure, President Carter appointed Treasury Under-Secretary Anthony Solomon to head a Task Force on Steel, to formulate a comprehensive program for the industry. Government intervention had so far employed tariffs, voluntary agreements, "dumping" legislation and a commission of inquiry, but the range of instruments which could be used to alter the terms of trade in domestic steel was limited by the nature of the political debate. The positions of the United Steel Workers, the Congressional Steel Caucus, the Council of Economic Advisors, the Special Trade Representative and the Departments of Commerce, Labor and Treasury reflected the industry's argument.

Profitability had to be restored to the industry without significant interference in management's autonomy to recover and adjust as it wished; furthermore, it was the government's responsibility to pick up much of the cost of adjustment for firms, workers and communities involved. (Borrus, 1983, p. 92)

Not surprisingly, the strategy of adjustment which emerged in the Solomon Program of December 1977, did not deal with the restoration of industry competitiveness.¹³ The immediate aim was to restore profitability under the implicit assumption that profits would be reinvested. The instrument by which this would occur was the "Trigger-Price Mechanism" (TPM) which had been accepted, in December 1977, by Japan, the EC, the United Steel Workers and the Congressional Steel Caucus. The United States steel industry had agreed to drop its anti-dumping petitions when the TPM was put in place.

Under the Trigger-Price Mechanism, which was initiated in April 1978, the Treasury Department established a reference price list to monitor 84 categories of basic steel products, representing 90 percent of basic steel imports. Prices were based on the average costs of production of each product in Japan, the world's most efficient producer, plus 10 percent overhead, 8 percent profit, and an amount to cover freight, insurance and handling. Imports entering the United States below the reference price trigger a "fast track" anti-dumping investigation to be conducted within two to three months, instead of the usual seven to nine months under the *Anti-Dumping Act*.

The immediate result of the Trigger-Price Mechanism was to permit price increases to restore profitability by suppressing foreign competition. Although import levels did not fall until 1979, the mechanism provided an effective price floor. In this way government intervention compensated for competitive inefficiency by restoring profitability without explicit adjustment conditions. By late 1978, the steel industry was operating at 90 percent of capacity, compared to its level of 70 percent of capacity in 1977 (Anawaty, 1979, p. 65). Employment also increased by 14,000 over 1977 levels (*ibid.*). The impact on consumers and other industries using steel as an input was less positive.¹⁴

In March 1980, President Carter suspended the Trigger-Price Mechanism when the United States Steel Company filed five anti-dumping suits in response to increased levels of import penetration. In September 1980, however, the Steel Tripartite Advisory Committee issued its *Report to the President on the United States Steel Industry* which, citing a capital shortfall of \$2 billion annually for modernization needs, recommended the restoration of the TPM (Borrus, 1983, p. 103). The TPM was restored at a 12 percent higher level, and a "surge" mechanism was included (*ibid.*); if there were a "surge" of imports when the import share of the American market was above 15.2 percent and domestic producers were

operating at less than 86 percent capacity, then steel producers could file anti-dumping petitions without suspension of the TPM.

By the end of 1981, however, the steel industry perceived the TPM as offering inadequate protection. In early 1982, U.S. steel companies filed petitions alleging that foreign steel producers were dumping steel in the American market. The industry sought countervailing tariffs against European steel imports. In October 1982, the International Trade Commission (which before the 1974 *Trade Act* had been the United States Tariff Commission) upheld the industry's allegations. Consequently, an agreement was reached between the United States and the EC to restrict exports to the United States of a wide range of steel products over a three-year period.

Apart from trade-protection policies, American steel companies are also aided by government subsidies, special tax provisions, subsidized loans and loan guarantees. The steel industry has more than \$550 million outstanding in government loans and loan guarantees, and receives approximately \$50 million per year in special tax benefits (Borrus, 1983, p. 180).

Thus, a strong political lobby composed of concentrated steel producers, highly unionized labour, and dependent communities has dominated the policy-making process. The result is that policy instruments have been directed at maintaining or restoring profitability through protection against import competition on the implicit, and yet to be proved, assumption that enhanced profitability will enable capital modernization, productivity improvements and the preservation of the industry on its present scale.

IMPACT OF INTERVENTION

Government policies have mostly retarded adjustment by the steel industry. Despite these policies, a degree of rationalization has occurred. From 1977 to 1979, the industry retired more than 5 percent of its capacity (Crandall, 1981, p. 144), and employment fell from 624,764 workers in 1965, to 452,000 workers in 1977 (Peabody, 1979, p. 52). The greater part of new major investment by large producers has been in the north-central part of the United States on the Great Lakes, in proximity to ore and transportation facilities (Crandall, 1981, p. 144). The four states with access to the Great Lakes — Ohio, Indiana, Illinois and Michigan — have increased their share of production to more than 50 percent of raw steel output in the United States (*ibid.*). This shift of production has corresponded with the shutdown of plants in other areas of the country and with diversification of steel companies into other industries. As noted earlier, the United States Steel Company has closed down a number of steel-making facilities and increasingly directed new capital investments to other sectors (Reich, 1983, pp. 182–83). Similarly, Bethlehem Steel laid off 10 percent of its work force in 1977, and closed

down a significant portion of its capacity (Borrus, 1983, p. 99). Other major steel companies have followed a similar strategy. For the most part, new capital investment out of protected profit margins to restore international competitiveness has not occurred, as contemplated by government policies, although adjustment out of a declining sector is a positive step in releasing physical and human capital to more productive uses. The emergence of profitable and competitive mini-mills and specialty producers within the industry suggests some intra-sectoral structural adjustment, although this development is not a direct product of government policies.

The policy instruments covered in this study have been firm directed. There are no assistance programs directed specifically at steelworkers to facilitate retraining, although steelworkers are eligible for adjustment assistance under the *Trade Act* of 1974.

The Textile and Apparel Industries

BACKGROUND

In the mid-1950s, the textile and apparel industries began to experience the pressures which have come to characterize a number of mature industries in developed economies: tightening markets, increased import competition, company failures and plant closings (Aggarwal and Haggard, 1983, p. 259). Until this time the industries faced minimal competition from imports which accounted for less than 2 percent of consumption in 1955 (ibid.). Firms confronted market changes in consumption patterns as clothing came to represent a lower percentage of consumer expenditure in a high-growth economy; these changes were the result of fashion shifts, competition from synthetic fibres, and rising labour costs in the northern United States. Responses to these pressures have taken the form of increased capital investment to reduce labour intensity and to realize economies of scale and specialization, mergers and relocation to lower wage-cost states in the South (ibid., p. 258). Nevertheless, the closure of mills, unemployment and low profit margins have continued to characterize the industry (ibid.).

GOVERNMENT INTERVENTION

The most significant policy response which the U.S. government has adopted to assist the textile and apparel industries is protectionism. The protectionist instrument used has been quantitative restrictions on imports negotiated within bilateral agreements. The industries have also been eligible for assistance under the trade-adjustment assistance program of the *Trade Act* of 1974.

In 1937, import penetration in cotton fabrics reached 1.5 percent of

U.S. production (Aggarwal and Haggard, 1983, p. 267). Government agricultural policy, in 1933, included a price-support system for cotton which forced American textile producers to purchase domestic cotton at higher than world-market price. The price support was supplemented by a quota on cotton imports. The effect of this policy was to endanger the competitiveness of American-produced cotton textiles. In 1937, textile producers were able to induce the government to conclude a voluntary restraint agreement with Japan to restrict textile exports. The pattern of responding to changing international market conditions by attempting to insulate the domestic market had begun. It took until the mid-1950s for imports of cotton-textile and apparel products to reach the 1937 level, although the industry had begun to lobby the government for import relief in 1950.

The American government did not react in any major way until 1957, when government policy evolved from a relatively free-trade position, partly based on the use of tariffs, to a bilateral system of import control on textile and apparel goods (Aggarwal and Haggard, 1983, p. 268). In that year a five-year agreement to restrain Japanese exports was negotiated. In October 1961, a one-year Short-Term Arrangement (STA) on textiles and apparel was negotiated under the auspices of the General Agreement on Tariffs and Trade (GATT). Under the STA, if "market disruption" occurred, importing countries could request that specific categories of imports be restricted for the period of the Arrangement at levels not lower than "base level" imports over the period of July 1960 to July 1961. The effect of the STA was to reduce the value of textile and apparel imports to the United States from \$268.7 million in 1960 to \$214.5 million in 1961 (*ibid.*, p. 281).

In May 1962, President Kennedy unveiled a more general plan to aid the textile and apparel industries. It consisted of seven measures:

- an expanded program of research covering new products, processes, and markets to be carried out by the Commerce Department in cooperation with management and union groups;
- a proposal to change the depreciation allowances on textile machinery;
- assistance from the Small Business Administration to "assist the cotton textile industry to obtain . . . financing for modernization of its equipment";
- a directive to the Department of Agriculture to recommend ways to offset the differential arising from the two-price cotton system (under which exports of cotton were subsidized, which permitted foreign producers to buy United States cotton at the world price which was 25 percent less than the domestic price, therefore penalizing domestic cotton-textile producers; the system was eliminated in 1964 at which point all cotton became subsidized);

- an assistance program such as was eventually created under the *Trade Expansion Act* for industries experiencing, or being threatened by, injury because of growing imports;
- a conference between exporters and importers of textile products to seek an understanding which would provide a basis for trade that would avoid undue disruption of established industries; and
- a policy that any application by the textile industry under the escape clause or national security provisions of the *Trade Agreements Extension Act* would be considered carefully on its merits.¹⁵

In October 1962, a Long Term Arrangement was negotiated with 19 countries as signatories, following the 1961 STA. The new arrangement permitted the negotiation of bilateral restraint agreements within its provisions. By 1966, the United States had negotiated 18 bilateral agreements. The LTA was to be in force for five years, during which an annual growth rate in the level of imports of 5 percent was permitted. The arrangement partly satisfied cotton and textile producers, but it did not deal with products of other fibres such as wool and synthetics. The wool sector was the weakest segment of the industry both industrially and politically, while synthetics were enjoying a trade surplus. The Kennedy administration wished to avoid protectionist measures dealing with those segments of the industry while Kennedy Round tariff-reduction negotiations were taking place.

In 1967, the LTA was renewed for three years. In 1973, a Multi-fibre Arrangement (MFA) was negotiated among American, Japanese and European producers to replace the Long Term Arrangement. The MFA was extended beyond cotton textiles to include wool, synthetic fibres and blends. A Textile Surveillance Body was established to monitor bilateral agreements, although it was given no enforcement powers. The overall quota growth rate was increased to 6 percent per year. Existing bilateral agreements had to be brought under the terms of the new arrangement, which was renewed in 1977.

American policy toward the textile and apparel industries became more restrictive in the fall of 1978, when a bill was passed by Congress to exempt textile and apparel products from Tokyo Round tariff reductions. In November 1978, President Carter vetoed the bill, but to save the Tokyo Round, which the industry was using its political strength to threaten, he produced the Administration's Textile Program White Paper on February 15, 1979. The White Paper promised careful monitoring of import quotas, a renegotiation of bilateral agreements to prevent "surges" of exports to the United States, and a "snap-back" clause (Aggarwal and Haggard, 1983, p. 305). This clause allowed tariffs to be restored if the EC nations carried out their threat to refuse to renew the Multi-fibre Arrangement. In 1981, the MFA was renewed; its renewal marked a turn to increased protectionism. Developed countries are free to negotiate

bilateral agreements without growth provisions for imports from the less-developed nations which have become highly competitive textile and apparel producers.

The fibre-textile-apparel coalition to promote protection has been led by the cotton-textile industry since the 1950s, when the industry first began its push for import relief. Both marginal and large producers were aligned in their focus on import restrictions. Although organized labour also supported a policy of protectionism, the Director of Research of the United Textile Workers of America believed that the government and the industry should extend the focus to domestic structural problems, since "if we stopped all imports we would not have solved our problem. This industry would still continue to shrink . . . if you read carefully the presentation of the American Cotton Manufacturers Institute, you would see that they begged you not to study or investigate the problems of the industry."¹⁶ Producers of synthetic fibres also joined the protectionist coalition, although they were not threatened by imports. Apparel producers, too, decided to follow the political lead of the cotton industry, even though low-priced textile imports helped the competitive position of the apparel industry. It was politically unfeasible, however, to oppose the textile industry, on which many apparel producers depended, since apparel producers were highly fragmented and poorly organized (Aggarwal and Haggard, 1983, p. 268).

The fibre-textile-apparel coalition was successful in orienting government policy to its demands. Successive Administrations failed to develop a political strategy to re-orient policy to address domestic structural problems including industry rationalization and restructuring, enhanced labour productivity, and the facilitation of the redeployment of redundant labour in other sectors.

IMPACT OF INTERVENTION

Some adjustment has occurred in the textile industry, despite government-policy efforts to preserve the status quo. Both the number of firms and the number of employees in the industry have declined as is evident from Table 3-1. While the total number of mills has declined by almost 20 percent, the number of mills with over 500 employees has declined by 13 percent, which suggests that between 1956 and 1977 the industry became more concentrated in an effort to realize economies of scale. Capital investment in the industry remains high, and productivity has increased during the 1970s. American textiles appear to have regained some of their international competitiveness, as exports tripled from 1970 to 1979.¹⁷ Synthetic fibres and textiles are the most competitive segments of the industry, and they are largely responsible for the increase in exports.

**TABLE 3-1 Number of Mills and Employees in U.S. Textile Industry
1956-1977**

	1956	1962	1966	1970	1977
Mills	8,231	7,441	7,035	7,009	6,702
Mills with 500+ employees	482	387	397	440	418
Employees	1,061,868	874,677	927,492	947,734	883,161

Source: Vinod K. Aggarwal and Stephen Haggard, "The Politics of Protection in the U.S. Textile and Apparel Industries," in *American Industry in International Competition*, edited by John Zysman and Laura Tyson (Ithaca, N.Y.: Cornell University Press, 1983), p. 260.

The Footwear Industry

BACKGROUND

Immediately following World War II, American footwear producers supplied 100 percent of the domestic market. By the early 1960s, the United States was the largest producer of shoes in the world, and firms continued to enter an industry in which barriers to entry were low. Since the mid-1960s, however, the industry has been in decline. All segments of the industry have been affected by imports as foreign producers have become increasingly competitive.

Footwear production is labour intensive, with limited potential for economies of scale. It does not require a highly skilled labour force, and workers have the characteristics of a secondary labour market, with high labour turnover and many secondary wage earners, mostly women. In the American industry, only 14 percent of workers are skilled, compared to an average of 20 percent in all manufacturing industry (Yoffie, 1983, p. 324). The average footwear worker earns \$3.50 per hour less than the average manufacturing wage; workers are relatively concentrated in the under-20 and over-60 age brackets; and women comprise 66 percent of employees compared to an average of 29 percent in all manufacturing (*ibid.*). Since labour costs account for up to 33 percent of the price of a pair of shoes, nations with low labour costs have a strong comparative advantage (*ibid.*, p. 325). There have been very limited increases in productivity or in the level of research and development in the industry. Moreover, the American industry has been relatively inflexible in its approach to fashion shifts. Therefore, it has lost competitiveness, compared to developing nations entering a low-technology, labour-intensive industry, and compared to European producers who lead in style design.

A portion of the footwear industry has been successful, however. Since the 1960s, firms have adjusted to new market conditions through

concentration. Large firms with both backward integration into sources of raw materials and forward integration into retail outlets have succeeded. The top 21 firms in the American industry now account for 50 percent of output, while the other 340 firms account for the remaining 50 percent (Yoffie, 1983, pp. 330–31).

The American footwear industry is regionally concentrated. Shoe factories are concentrated in small towns in the northern and Atlantic states,¹⁸ and are often a town's principal employer. Thirty percent of factories are in localities with a population of less than 5,000, while 4 percent are in towns with 5,000 to 20,000 inhabitants (Yoffie, 1983, p. 337). The regional character of the industry and the characteristics of its labour force have made adjustment more difficult. There are obvious difficulties in relocating or retraining the majority of workers in a town, particularly when they are largely unskilled and are secondary earners.

GOVERNMENT INTERVENTION

Before President Carter's program of April 1977, entailing the negotiation of Orderly Marketing Arrangements to restrain the exports of foreign producers, government intervention in the footwear industry was negligible. The 1970 and 1974 *Trade Acts* did not provide substantial assistance to the industry, and the executive was reluctant to act in 1971, when the United States Tariff Commission found injury, and in 1976, when the International Trade Commission recommended tariff-rate quotas to protect the industry. The industry was unable to lobby the government effectively or to generate a perception of crisis in its operation as the steel lobby had done successfully. It was, therefore, very late in receiving assistance.

In 1971, President Nixon agreed to extend adjustment assistance to 11 firms under the Trade Adjustment Assistance program of the 1962 *Trade Expansion Act*. In February 1976, the International Trade Commission again recommended government action, but was undecided over the form that that action should take. In January 1976, President Ford had sought Orderly Marketing Arrangements for steel. The Administration decided, however, that seeking protection for footwear would threaten the goal of free trade, disrupt the Multilateral Trade Negotiations, possibly lead to retaliation against the United States, and be costly, since the suggested tariff-rate quota would cost American consumers \$750 million annually (Yoffie, 1983, p. 337). Instead, President Ford extended additional adjustment assistance and proposed a system to monitor imports. In January 1977, the International Trade Commission (ITC) recommended a tariff-rate quota on non-rubber footwear to protect the industry from further damage. In February 1977, the ITC recommended a stringent five-year quota. Congress was also demanding action. In April

1977. Orderly Marketing Agreements (OMAs) were decided upon as a compromise instrument (Destler, 1980).

On April 1, 1977, President Carter began to negotiate Agreements with Korea and Taiwan to restrict exports. In the same year, the Commerce Department organized a Footwear Industry Team. Its task was to speed up firm and worker certification for trade-adjustment assistance, provide consulting services to shoe manufacturers, promote exports, encourage technological development, and initiate a "buy American" campaign.

Orderly Marketing Arrangements have had several effects. When faced with quantitative limits, exporters shifted production to higher-quality goods in order to maintain total earnings with a lower sales volume. New unrestricted countries entered production so that Hong Kong replaced Taiwan and Korea in the low-quality, mass-volume section of the market. Prices increased because of anticipated supply reductions, and foreign producers made windfall profits by shipping products before OMAs took effect. Since OMAs covered non-rubber footwear, foreign producers began to add rubber to the heels and soles of shoes to escape restrictions. In the first quarter of 1977, despite the OMAs, imported rubber and non-rubber footwear held 52 percent of the U.S. market; by the first quarter of 1979, this figure had reached 55 percent (Destler, 1980, p. 345). In 1981, President Reagan dismantled the OMAs, but provided no substitute. The executive's political compromise with Congress was to initiate "voluntary export restraints" on automobiles, in lieu of providing continuing protection for the footwear industry.

American policy toward the footwear industry has been largely a pragmatic political response to an industry with limited political influence. Assistance, therefore, has been extended reluctantly and has been protectionist rather than adjustment oriented.

In the 1970s, the footwear industry began to perceive low-cost foreign labour as the source of its comparative disadvantage. The American Footwear Industries Association, labour groups and Congress argued for government intervention. On the other hand, importers and retailers lobbied against protection and were able to organize foreign governments to add their weight to the lobby. On balance, these lobbyists were more potent political forces than was the industry. Although the industry did have some Congressional support, unlike the textile industry, which was able to mobilize widespread political support, it did not have enough support to threaten the enactment of major legislation to force the Administration to act. The footwear industry is relatively small. Its lobby group, the American Footwear Industries Association, has not enjoyed substantial support from the large firms in the industry whose survival does not depend on protection. The existence of profitable firms in the sector has hurt the industry's chances of obtaining assistance by

TABLE 3-2 The American Footwear Industry

Production	Employment	Number of Plants
% change 1968–1976	% change 1968–1976	% change 1968–1976
–36.04	–34.6	–33

Source: Adapted from data presented in David B. Yoffie, "Adjustment in the Footwear Industry: The Consequences of Orderly Marketing Arrangements," in *American Industry in International Competition*, edited by John Zysman and Laura Tyson (Ithaca, N.Y.: Cornell University Press, 1983), p. 325.

Note: United States average of principal producing states (Pennsylvania, Massachusetts, Maine, New Hampshire, Tennessee, Arkansas).

reinforcing the view that the industry at large should be able to adjust. A fragmented labour force with high turnover and many secondary earners has reduced labour's influence on the policy process. The industry's strategic failure was its inability to mobilize the necessary support within the executive branch. Tactically, it filed injury petitions at a time when the Administration was not predisposed to provide import relief (Destler, 1980, p. 337). The textile and steel industries filed petitions at the same time as the footwear industry (1976 to 1977), during the course of the Tokyo Round Trade Negotiations. Textiles and steel, however, had been able to use their Congressional influence to threaten to block any legislation designed to permit the Administration to negotiate tariff cuts. Therefore, the executive was forced to "buy off" these industries with protectionist measures, to prevent them from leading a broad protectionist coalition. Footwear had less political salience and was maintained by the Administration as a good example to the rest of the world of a "free trade" sector. While the negotiation of Orderly Marketing Agreements with Taiwan and Korea, in 1977, yielded some protection against import competition, their partial coverage of all imports and ease of circumvention reduced import pressures only modestly.

IMPACT OF INTERVENTION

Of the industries examined in this chapter, the footwear industry has displayed the least ability to prevail upon government to retard the process of adjustment and to insulate the domestic market. The industry's structure continues to be labour intensive, low skill, low technology and regionally concentrated. Resources have continued to move out of the industry. Tables 3-2 and 3-3 indicate the degree to which production, employment and the number of plants have declined, and the tendency of the industry to greater concentration in efforts to capture economies of scale. The number of large firms and the proportion of total output which they produce has increased.

TABLE 3-3 Number of United States Footwear Producers and Percentage of Total Output, by Size of Firm, 1967-1975

Producer Size (number of pairs)	No. of firms	Percent of total output	No. of firms	Percent of total output	No. of firms	Percent of total output
Small						
Fewer than 200,000	226	2	129	2	-97	0
200,000-499,999	170	10	92	7	-76	-3
500,000-999,999	121	14	71	12	-50	-2
Medium						
1,000,000-1,999,999	100	24	42	14	-58	-10
2,000,000-3,999,999	42	19	23	15	-19	-4
Large						
4,000,000 or more	16	31	21	50	5	19
Total	675		378		-297	

Source: Adapted from statistics presented in David B. Yoffie, "Adjustment in the Footwear Industry: The Consequences of Orderly Marketing Arrangements," in *American Industry in International Competition*, edited by John Zysman and Laura Tyson (Ithaca, N.Y.: Cornell University Press, 1983), p. 330.

The Shipbuilding Industry

The United States does not rank among the world's major shipbuilding nations, which include Japan, France, West Germany and the United Kingdom. To justify assistance to shipbuilding yards, however, it has used the rationale that a shipbuilding industry is important for reasons of national security (Mayer, 1977, p. 56). National security entails the need for carrying capacity in the event of international conflicts. Shipyard capacity is needed to provide the required maintenance and restoration of ships in the National Defence Reserve Fleet, to replace vessels lost to enemy action in a conventional war, and to provide repair and maintenance facilities for friendly merchant ships during war. Assistance, following the pattern noted in other declining industries in the United States, tends toward insulation of the domestic market to protect American shipyards from foreign competition.

The current U.S. program dates back to the *Merchant Marine Act* of 1936, which provided an extensive range of subsidies and other support to American maritime sectors. This Act supplements the *Jones Act* of 1920, which required that all domestic water-borne cargo of the United States must be transported on American-constructed, -owned and -operated vessels. Both pieces of legislation remain in effect. Other demand-side regulations aimed at assisting the industry include the rule of cargo preference, which specifies that one-half of all cargoes moving in international commerce which are government owned or government impelled (and 100 percent of military cargoes) must be carried aboard American vessels if such shipping is available at fair prices. Government procurement also plays an important part in maintaining the industry. In the mid-1970s, approximately one-half of the output of the privately owned shipyards in the United States consisted of the construction of new military ships and repairs on military ships (OECD, 1975b, p. 70).

American shipyards are also assisted by grants and the provision or guarantee of credit. The Construction Differential Subsidy (CDS) aims to enable American shipowners to construct vessels in the United States at a cost comparable to that of construction by foreign competitors. The subsidy maximum now stands at 35 percent, a figure which has declined since the *Merchant Marine Act* of 1936. Any ship built under the program must operate under the United States flag for at least 25 years. In a 1970 amendment to the Act, the subsidy was expanded to include tankers and other bulk carriers operating in the foreign commerce of the United States. Under the Title XI Ship Mortgage Guarantee Program, government guarantees on shipbuilding orders cover up to 75 percent of construction costs of vessels covered by the CDS. Non-subsidized construction projects qualify for guarantees of up to 87.5 percent of vessel cost. The emphasis in this program is on financing energy-oriented vessels such as liquid natural-gas (LNG) carriers and tankers. In the

early 1970s, the majority of construction projects subsidized under the CDS program were LNGs and tankers (Mayer, 1977, p. 54).

The U.S. maritime program has not attempted to deal seriously with the world shipbuilding crisis which has existed for a decade. There has been little effort to induce shipyards to modernize or rationalize, and there are no programs to encourage the scrapping of capacity. The American approach has been to employ largely protectionist instruments which insulate, and thereby preserve, the domestic industry. The world situation remains one of oversupply, particularly as less-developed nations enter the industry.

Conclusions

The American pattern of policy making in relation to declining sectors is tied closely to the nation's political and industrial traditions. Since government intervention in the economy is not widely accepted on a theoretical or ideological level, the initiative for assistance has come largely from industry and organized labour. Thus, the policy response to declining industrial sectors takes a highly politicized ad hoc approach which depends on the political strength of a particular industry. Industry associations have tended to divert the issue from domestic competitive inefficiency to that of allegedly unfair trading practices on the part of other nations. Assistance, then, is directed to the objective of providing time to deal with import competition. Protection is intended to restore profitability on the assumption that profits will be reinvested in modernization.

It is the politically salient groups (trade unions and industry associations) which are most likely to be effective in promoting assistance measures. Industry groups and labour organizations have been appeased most easily by protectionist measures which retard economic adjustment by insulating the domestic market, thereby artificially maintaining industrial output and employment. American policy makers have generally failed to address the need for structural adjustment within declining industries, and to direct policy to this goal while easing the costs of adjustment. Instead, the United States has taken an approach that focusses on protecting industries from injury resulting from import competition. Assistance has been on the level of trade policy and not on the level of industry restructuring, since the American political tradition does not accept an active state role in industrial decision making.

Assistance to declining industries has included both general programs, such as the Trade Adjustment Assistance Program of the *Trade Act* of 1974, and sectoral assistance. Trade-adjustment assistance was intended to compensate workers and firms hurt by liberalized trade policy. It has not, however, facilitated more rapid adjustments to shifts in market conditions. The program encourages the retention of workers and firms in an industry rather than their exit. Explicit compensation in

the form of subsidies to workers who returned to work in the same firm from which they had been laid off, and loan guarantees to firms which may be provided to a firm *expanding* in a *declining* industry, have weakened adjustment pressures. American labour interests have tended to ally themselves with industry interests in promoting protection and have not strongly supported retraining or relocation programs. The result has been the adoption of compensatory measures directed at income maintenance, which have provided only symptomatic relief for dislocated workers.

Assistance to the steel, textile, footwear and shipbuilding industries has centred on protection from "unfair" competition and has been responsive to pressure from industry associations for time to adjust. Thus the steel industry has been assisted by tariffs and import quotas and the Trigger-Price Mechanism. The prices of imported steel are monitored, and any which fall below the reference price may trigger an investigation. The TPM is testimony to the steel industry's political strength and its ability to frame the policy debate in its own terms and thus deflect adjustment processes. Although a degree of rationalization has occurred in the industry, despite government policy, investment directed to the production of high value-added products has occurred only to a limited degree. The textile industry has also been insulated from industrial change. Successive import restraints negotiated at bilateral and multilateral levels have protected domestic market share and permitted marginal producers to remain viable. Footwear was less successful than textiles in shaping the policy debate and has received less extensive protection. While regionally concentrated, the unconcentrated nature of the firms and work forces in the industry has inhibited effective political mobilization by both capital and labour. Perhaps it is because footwear has had greater exposure to international competition that a competitive segment has developed within the industry. The Orderly Marketing Arrangements (a form of import quota), pursuant to which the United States has attempted to maintain a share of the world market were introduced later in the industry's history and provided less complete insulation from import competition.

Thus American policy directed at declining industries has often been largely counterproductive economically. Rapid adjustment to industrial change has not been a prominent feature of government policy toward these industries. Instead, industry and government policy goals have converged around attempts to preserve the status quo. Notwithstanding these policies, substantial adjustments in these industries have occurred. Thus adjustment pressures have, at most, been retarded or deflected, but have not ultimately been completely defied.



The United Kingdom's Policy Approach to Declining Industrial Sectors

The Policy-Making Process

The challenges posed by industrial decline have absorbed a considerable amount of government energy and resources in the United Kingdom over the last two decades. Undoubtedly, government concern over industrial decline is related to the dismal performance of the British economy. In terms of growth and labour productivity, the performance of the British economy places it in the cellar of Western industrialized nations; annual growth averaged .3 percent between 1970 and 1980, while productivity increased by a meagre 1.2 percent between 1974 and 1981 (McKay and Grant, 1983, Tables 2, 3).

To address the decline of certain industrial sectors, successive British governments have formulated both general and industry-specific measures. Despite the magnitude of the problem, however, and the government's sensitivity to it, the policy that has been developed in this area is largely ad hoc and reactive in nature. In the view of two commentators, such initiatives have "not match[ed] up to the scale of the crisis."¹

The formation of industrial policy in the United Kingdom has often been characterized by contentious debate between the two major parties. Labour has traditionally been committed to highly interventionist policies, while the Conservatives have relied heavily on "non-interventionist" and "disengagement" slogans in their policy platforms. Despite the fervour with which the parties have staked out their positions during election campaigns, it is clear that upon election to parliament, at least until the period of the current Conservative government, the commitment to highly polarized platforms has been weakened, and the differences between the two major parties have often appeared to have been more rhetorical than real.

The two major national interest groups that have endeavoured to exert influence over industrial policy are the Trade Union Congress (TUC) and the Confederation of British Industry (CBI). The TUC is the national umbrella organization for half of all organized labour. Ironically, although it enjoys "the highest level of union membership when compared to all modern democracies" (Ashford, 1981, p. 141), it has been unable to galvanize its membership to form a single cohesive bloc. The fractious nature of the Congress is attributable, for the most part, to the role of powerful independent unions. These unions have readily rejected the views advanced by the TUC if they were at odds with their own interests.

The TUC enjoys a special relationship with the Labour Party. This relationship, which has aligned the TUC with the Labour Party, was cemented in 1900, following prolonged negotiations. It has not always been harmonious. Although the TUC continues to provide the Labour Party with about 90 percent of its funds, the influence of the Congress in the party has waned in recent years. "Members of the TUC general council no longer sit on the party's National Executive Committee, and gradually the lines between the party and the unions have been more clearly drawn" (Ashford, 1981, p. 144).

Management is represented by the Confederation of British Industry (CBI). In the past, the Confederation has been characterized by fragmentation and discord; recently, it has become more highly organized and, as a consequence, more effective. The organization enjoys close contact with government on industrial policy matters and is considered the "most important interest group in the industrial policy area" (Grant, 1982, p. 40). Constituent product and sector industry groups are also active in industrial policy formulation, and they sometimes even supplant the CBI to a large extent.

The organization of these two groups suggests that the evolution of truly national policies can be undercut by the efforts of individual unions and industries. These groups have often been able to mobilize their substantial resources to defeat industrial policy initiatives involving reductions in industry employment or output.

Authority for designing industrial assistance policy is dispersed through a number of government departments and agencies. Since 1974, the premier department has been the Department of Industry (DOI). Its responsibilities range from managing nationalized industries, such as British Steel Corporation, British Shipbuilders and British Leyland, to coordinating and controlling the industrial policy initiatives of other departments. The Departments of Treasury and Trade, the Scottish and Welsh Offices, and various other central ministries also play an active role in industrial policy formulation through the principle of sponsorship as, of course, do the prime minister and cabinet. This structure of policy formulation has nurtured an environment conducive to inter-departmen-

tal rivalry. Since the Departments of Industry and Trade split in 1974, for instance, they "tread different and often crossed paths, besides waging sporadic war with Treasury" (Curzon-Price, 1981, p. 37). As in other countries, interest groups have been able to exploit these cleavages by playing off competing departments against one another, and by entering into alliances with those departments that are most sensitive to their interests.

The British financial system is not closely integrated with either industry or the government, with the result that the government does not look to the financial system to help promote industrial restructuring. The British investment institutions, merchant banks and commercial banks all maintain arm's length relationships with industry. The increasingly large and few British investment institutions might be expected to use their large equity holdings to influence company policies, as do French and German banks. These institutions, however, are, for the most part, content to make arm's length judgments about future stock prices; they have neither the expertise nor the inclination to become industrial advisers (Zysman, 1983, p. 191). Moreover, their equity holdings are more fragmented than the concentrated holdings of French or German banks, which have often conferred on the latter an ability to affect industrial policy (*ibid.*).

Unlike French banks, British merchant banks do not intervene in the management of the firms to which they lend (Zysman, 1983, p. 197). French banks not only lend to companies, but invest in these companies, as well, which encourages the banks to become involved directly in industrial re-organizations (*ibid.*, pp. 196–97).

British commercial banks, unlike French and German banks, are not closely tied to industry either by shareholdings or by the provision of long-term loans. Loans from commercial banks tend to be short term for two reasons. First, there is the prevailing view that the stock and bond market is available as a source of long-term lending, and that British banks should limit themselves to supplying short-term financial requirements (Zysman, 1983, p. 193). Secondly, British firms tend to finance expansion from savings and the sale of equity, rather than from credit (*ibid.*). These considerations permit the commercial banks to function without a detailed understanding of their client companies or any ongoing concern with industrial management (*ibid.*, p. 192).

The British government and financial system are not closely integrated. The government does not control channels of borrowing and lending which would facilitate the selective manipulation of credit by the government (Zysman, 1983, p. 197). Government intervention, through the Bank of England, takes the form of reserve requirements or open-market operations which preserve the market character of the system (*ibid.*, p. 198).

In response to calls for the nationalization of U.K. financial institu-

tions by left-wing labour members, the Wilson Committee was established in 1977 to review the functioning of financial institutions. The committee found that neither banks nor lending institutions had denied investment funds to industrialists requiring them (Zysman, 1983, p. 223).

General Programs

The Industry Acts of 1972 and 1975

The *Industry Acts* of 1972 and 1975 embody the principal legislation governing industrial policy in the United Kingdom. The 1972 Act was passed in mid term by the Heath Conservatives. Its enactment reflected an increasing disillusionment in Conservative ranks with the government's commitment to non-interventionism. Indeed, the Act, which provided for the extension of considerable assistance to firms and industries, constituted the "most comprehensive armoury of government control that has ever been assembled for use over private industry."² This constituted a dramatic departure from the position to which the Conservatives were committed at the time of their election to office.

Specifically, the 1972 Act contained several provisions which set out the framework within which selective assistance would be made available to ailing industries. The most important provisions were found in sections 7 and 8. Section 7 concerned "discretionary government assistance to projects that created or safeguarded employment in assisted areas or regions" (Grünt, 1982, p. 51). Section 7 assistance was used to complement the major form of regional assistance, the Regional Development Grant. Section 8 allowed the government to extend discretionary assistance to industries or areas, irrespective of their regional development status. Essentially, the availability of section 8 assistance would be guided by the benefits which would accrue to the economy and the national interest, subject only to the requirement that the private sector not be willing to lend its support to such a project.

Under successive governments, sections 7 and 8 have undergone notable evolution. In 1975, the Labour government removed the provision in section 8 which stipulated that assistance be contingent on the unavailability of private sector financing. The Thatcher government, however, reintroduced this requirement in its *Industry Act* and made it applicable to section 7 as well. In addition, the government stipulated that section 7 assistance could be extended only after it was demonstrated that as a result, the regional or national economy would be strengthened and made more productive or secure jobs generated. Section 8 assistance would be offered to attract internationally mobile projects or projects which would lead to substantial improvement in performance or to the introduction of new products.

Although the *Industry Act* has undergone significant change since it

was first introduced in 1972, its legislative thrust remains the same: that is, to accelerate the rationalization of investment and to promote innovative investment. Basically, these objectives have been pursued at the levels of the firm and the industry, and on a general basis. Each of these initiatives will be examined briefly in turn.

Firm-specific measures have been undertaken on an ad hoc basis and involve the bail-outs of severely debt-ridden firms. Examples of such assistance can be found in the industry case studies presented below. At one stage, government-led rescues consumed one-half of expenditures under section 8 (Grant, 1982, p. 32). Sectoral schemes involve grants tied to the "four Rs": re-equipping, rebuilding, rationalization and restructuring. Under the Labour government, sectoral programs were formulated after the receipt of recommendations from the National Economic Development Council (NEDC), which is discussed below. General assistance schemes were designed to encourage new industrial investment. In 1975, Labour introduced an Accelerated Projects Scheme (APS) which was to exert a counter-cyclical effect on the economy in recession by encouraging new investment. During its short life of a single year, it assisted 111 projects with payments of £72 million (*ibid.*, p. 31). The successor to APS, the Selective Investment Scheme, was established to encourage companies to undertake major projects (costing more than £500,000) that would otherwise be abandoned, built abroad or executed on a smaller scale. By the time that the Thatcher Conservatives terminated the program, more than £106.5 million had been allocated to 166 projects involving total capital outlays of over £1.6 billion (*ibid.*).

Other general programs specifically designed to address the difficulties sustained by declining industries were administered by the Industrial Reorganization Corporation (IRC), the National Enterprise Board (NEB), and the NEDC. In addition to the plethora of measures developed by these agencies, both regional and labour policies exerted an effect, albeit peripheral, on declining sectors. A sketch of each is provided below.

The Industrial Reorganization Corporation

The IRC was set up by the Wilson government to encourage "mergers which were thought to be justified on grounds of economies of scale, better management, or improved international strength" (Fleming, 1980, p. 143). The rationale for government intervention was twofold:

- the putative existence of imperfections in private capital markets which distort the calculation of gains from merger activity; and
- the ability of a government agency such as the IRC to work in harmony with other government bodies, so as to discourage unwarranted mergers, while encouraging desirable ones (Zysman, 1983, p. 217).

The goals of the IRC were facilitated by the extension of assistance in the form of loans and grants. The corporation's success in promoting the restructuring and rationalization of British industry through mergers was undermined by its acquisition of "lame ducks." The election of a Conservative government committed to "non-interventionism" sounded the death knell for the corporation. The IRC was one of the first targets of the Heath government. It was dismantled in 1971.

The National Enterprise Board

The National Enterprise Board (NEB), created by the Labour government in 1975, symbolized Labour's disillusionment with what could be achieved through nationalization (Grant, 1982, p. 101). It was constituted in order to fulfill the government's desire to "acquire a share in the profitable end of British industry" (Curzon-Price, 1981, p. 58). In carrying out its mandate, the NEB would "combine the advantages of public sector financial resources [with] the private sector's entrepreneurial approach to decision-making" (Grant, 1982, p. 104). In fact, it enjoyed only limited success in acquiring a stake in profitable firms. Its difficulty in forming a portfolio of robust firms largely related to the contradictions inherent in its mandate. The NEB's investment activity was to facilitate "the promotion of industrial efficiency and international competitiveness [while ensuring] the provision, maintenance or safeguarding of employment" (Curzon-Price, 1981, p. 58). Considering the pervasiveness of overmanning in British industry, it was unclear how the first goal would be achieved while ensuring the realization of the second. Actually, the track record of the NEB indicates that excessive attention was paid to employment concerns, which caused the board to assemble a portfolio dominated by ailing firms. By the latter part of the decade, the board enjoyed only a peripheral role in the industrial policy process because its resources had become almost exclusively dedicated to dealing with the "lame ducks" that it had acquired.

The National Economic Development Council

The National Economic Development Council (NEDC) is a tripartite body which advises the government on issues relating to declining industries. It was established in 1962, although it did not assume national prominence until the Labour government cast it in the role of a central player in its industrial policy. This change was inspired largely by the perceived success of *dirigiste* approaches to industrial decline in France and, to a lesser extent, in West Germany. Under Labour, the NEDC became the focal point for contact between labour, management and government interests.

Under the purview of the NEDC, a number of sectoral working parties (SWPs) have been set up to investigate the needs and prospects of ailing sectors. Thirty-nine such committees have been established, covering 40 percent of the output of manufacturing industry (Grant, 1982, p. 63). The efficacy of the corporatist approach embedded in the NEDC is suspect. To begin with, the committees under the NEDC have been haunted by the "danger that such institutionalized attempts at problem solving [which embrace] the representatives of existing interests, become too preoccupied with existing organizations and patterns of production and devote too little or no attention to dynamic springs of progress" (Fleming, 1980, p. 151).

This problem becomes especially acute when targets for each major sector and product are defined. Admittedly, risk and uncertainty are reduced by such planning, but so, too, is the incentive to introduce innovative solutions to structural problems. Moreover, even if innovative solutions are found, it may be difficult to secure the support of the other constituent interests of the working party. As one observer has noted: "only exceptionally have [NEDC sectoral parties] been able to turn their conclusions and recommendations into direct action" (Grant, 1982, p. 34).

Regional Policy

Regional policy in the United Kingdom has been aimed at increasing industrial activity and reducing unemployment in depressed areas of the countries. Historically, regional policy has been tied closely to industrial policy. In fact, it has been suggested that British industrial policy objectives have been defined mainly through the prism of solving regional problems (Curzon-Price, 1981, p. 56).

The principal tool for regional assistance in the United Kingdom is the non-discretionary regional development grant, which is awarded automatically to any firm in possession of an Industrial Development Certification. The level of the grant is based on a proportion of qualifying assets, which varies in accordance with the location of the firm. The regions receiving the most assistance are called Special Development Areas (SDAs), while Development Areas (DAs) and Intermediate Areas (IAs) receive lower levels of assistance.

Under the Labour Government, expenditure on regional aid peaked in 1975/76, but thereafter declined (Grant, 1982, p. 59) as selective assistance measures were favoured. Expenditure on regional aid has declined under the Conservative government, which has reduced the scope of the program. Under the 1974–79 Labour government, 40 percent of the employed population was subsidized indirectly by regional development assistance; by 1982 this figure stood at 27 percent (Grant

and Wilks, 1983, p. 20). Most of the cutbacks in assistance were borne by firms and workers located in the IAs.

The Thatcher government has questioned the long-term value of regional aid ("Free-for-all," 1984, p. 57); either the companies that receive the regional hand-outs would have located there anyway (for example, North Sea Refineries in Scotland or the North-east), or they are encouraged to invest in fragile branch factories that will not weather a recession (*ibid.*). Thus a December 1983 government White Paper proposed a switch of emphasis from automatic aid to selective aid, and a direct link between the residual automatic aid and the number of jobs created ("Another No," 1984, p. 56).

Labour Policy

British policy which has developed to meet the needs of redundant labour is imbued with an adjustment-retarding bias which operates not unlike the way in which the challenges posed by industrial decline have been approached at a sectoral level. There are no general labour-adjustment schemes in the United Kingdom which parallel the scale and depth of the comprehensive schemes observed in West Germany. Rather, British employment policy has placed a premium on unconditional income-maintenance schemes and temporary employment subsidies which have worked to reduce the mobility of displaced labour. Moreover, British public housing policies have created severe disincentives to worker mobility.

Unemployment Benefits Program

Unemployment benefits are made available to unemployed workers for up to one year. For the first six months of unemployment, these benefits comprise a standard rate calculated on the basis of the number of the unemployed worker's dependents and an earnings-related supplement. This supplement may enable the worker to enjoy up to 85 percent of prior income, though it may be withdrawn from workers refusing retraining. It is not offered after six months' unemployment. In addition to these benefits, lump-sum redundancy payments are made available to workers employed for over two years in their last job.

After unemployment benefits run out, workers who still cannot find new employment are eligible for the Supplementary Unemployment Benefits Program. These benefits are made available indefinitely on a "needs basis."

Temporary Employment Subsidy

The Temporary Employment Subsidy (TES) was introduced in 1975 as a

temporary measure, but was later extended until 1979. The Conservative government replaced the TES with a temporary short-term compensation scheme, which, except for a shorter benefits period, was similar to TES. TES is made available to firms which forestall laying off 10 or more workers. The government dispenses £20 per worker per week to firms participating in the program. £20 is equivalent to one-half the level of standard benefits available under the Unemployment Benefits Program. The subsidy is available for up to one year. Lindley (1980, p. 343) reports that the vast preponderance of funds extended under the scheme went to the textiles industry.

When funds were exhausted under TES, firms were eligible to receive a further subsidy under the Temporary Employment Subsidy Supplement Program. This assistance was available for up to six months after the termination of benefits under TES. The level of benefits offered was one-half of the benefits under TES.

At its peak in 1977, TES assisted 204,700 workers indirectly. By 1979, however, only 44,300 workers were enrolled in the program. In 1978/79, the program disbursed £135 million in assistance (Lindley, 1980, p. 344).

TES has been criticized because of its adjustment-retarding effects. No provision in the program's eligibility criteria distinguished between short-term cyclical unemployment and long-term structural unemployment. This lack of distinction has led to the concern that a number of workers were maintained at jobs from which they ultimately would be made redundant because of an industry's structural decline.

Training Opportunities Program

The Training Opportunities Program (TOP) was instituted in 1972, to provide training to workers who wanted to acquire new skills or upgrade the ones they currently possessed. Workers could receive, on average, six to 12 months training in either an institutional or an industrial context. A standard rate was offered for living expenses, with a modest earnings-related supplement. In 1976, nearly 90,000 people completed these courses, and a target of 100,000 completers was set for 1980 (Mill, 1981, p. 101). The majority of participants in the program are redundant workers.

TOP has been criticized because of its short-term emphasis; the success rate for TOP completers in finding new jobs is low. Moreover, Lindley (1980, p. 363) has found that the training programs administered by TOPS were not related to the actual needs of employers. Compounding the problems of the program is the "displacement effect" noted by Mill (1981, p. 102): "It seems to be the case that, as government training has increased, training by employers has declined, and that comparatively little of the public effort has been directed towards the needs of the manufacturing sector."

Employment Transfer Scheme

The Employment Transfer Scheme (ETS) was established in 1972, to accelerate employee mobility. Under ETS, grants and allowances are made available to workers to move to new employment opportunities. A benefits supplement is made available to workers moving from high unemployment areas. Grants and allowances subsidize moving expenses and reduce the costs of separation from an employee's family. There is no assistance provided, however, for job-search trips. From 1976 to 1977, £11.2 million was directed to 22,000 workers. Of this sum, 40 percent went to recently graduated students (United States, 1979).

Sectoral Programs

The Motor-Vehicle Industry

BACKGROUND

The motor-vehicle industry is of central importance to the United Kingdom's economy; in late 1976, the industry accounted for 8 percent of gross domestic product (GDP), 16 percent of total manufacturing exports, and 6 percent of total employment (Rhys, 1980, p. 182). The industry is currently comprised of four major producer groups: Ford, General Motors (Vauxhall), Chrysler (now Peugeot), and British Leyland (BL). With the exception of BL, all of the firms in the industry are subsidiaries of foreign-owned companies. The four-firm structure of the industry today stands in stark contrast to the large number of firms which constituted the industry in 1945. The transformation of the industry was doubtless dictated by the high and rising minimum efficient scale involved in motor-vehicle manufacture: in the early postwar years, minimum cost could be realized by an output of a half a million units a year, while in the 1970s, a million or more units were needed to achieve this goal (Pollard, 1983, p. 290).

As in many other developed countries, the government has played a pivotal role in shaping the nature of the motor-vehicle industry. Its policy, however, unlike that of other countries, has focussed not on aiding the development of the motor-vehicle industry, but rather on using the industry to further general economic goals.

In the 1940s, for instance, the U.K. government encouraged export of motor vehicles in order to shore up the country's balance of payments. Moreover, in the 1950s, the expansion of the industry was directed to high-unemployment areas in order to realize regional development goals. However, the reliance of successive governments on the motor-vehicle industry to achieve goals which were often external to industry objectives had the effect of hindering efforts to accelerate rationalization

in the industry. In the 1940s and 1950s, the industry was distracted from its own goals without great cost. In the face of an expanding market for motor vehicles and a dearth of competition, British manufacturers were able to maintain their grasp of both the domestic and the foreign market. By the 1960s, however, government policy was beginning to have deleterious effects on industrial development.

The effects of industry subservience to the dictates of general economic policy are most apparent in terms of industry profitability. Between 1967 and 1971, the return on capital in the British motor-vehicle industry was one-third that of the German industry (Dunnett, 1980, p. 124). Low levels of profitability jeopardized the continuance of investment, as well as extensive research and development. As a consequence, changes in production techniques which would increase productivity were introduced only slowly. By the early 1970s, productivity in the industry lagged far behind that of competing industries in other countries: in 1973, 5.1 vehicles were produced per employee-year in the United Kingdom, compared to 14.9 in the United States (Rhys, 1980, p. 185). The disparity in industry productivity also is illustrated by comparing plants assembling identical cars in different countries. In 1975, the "British plant needed 67 percent more labour to produce a Ford Escort than a German [plant], 87 percent more for the Cortina than the Belgians needed for the Taurus, and 132 percent more than the Belgians for a Mini" (Pollard, 1983, p. 290). Moreover, low levels of research and development activity hindered product design. One commentator observed that in 1975, many British motor-vehicle designs dated back to the 1960s, and some were 10 years older than their competitors' (Dunnett, 1980, p. 124).

The high rate of industrial conflict has hindered further the motor-vehicle industry's ability to raise productivity. In 1972-74, 10 to 26 percent of the industry's productive capacity was lost because of labour disruptions (Rhys, 1980, p. 185). These disruptions have involved the 20 or so unions that represent the industry work force. Wage disputes are the primary manifestation of industrial tension, but that tension also involves issues ranging from the inability of low-productivity firms to pay higher wages to the lack of confidence engendered by many years of government "stop-go" measures (*ibid.*).

Indeed, the share of the domestic market held by British manufacturers slipped from 97 percent in 1961, to 72.6 percent in 1973,³ to the current 42 percent. Although domestic production increased in the two postwar decades, the pace of increase in production was inadequate by international standards. In the period 1955-64, for instance, production of motor vehicles increased by 88 percent in the United Kingdom and by 195 percent in countries outside the United States and the United Kingdom (Pollard, 1983, p. 288).

These figures underline the "unprofitable, outdated and uncom-

petitive" complexion of the motor-vehicle industry as it entered the 1970s (Dunnett, 1980, p. 167). They also explain the government's growing concern with the survival of the industry in the past decade. Increasingly, the government became sensitive to the need to form policies which would have the effect of enhancing the competitiveness of the industry and retreated from its historical reliance on the industry as a tool to achieve broad economic goals.

GOVERNMENT INTERVENTION

The primary objective of the motor-vehicle policy fashioned by the British government in the 1970s was the rationalization and restructuring of motor-vehicle production. Aid to industry was extended in three forms: trade protection, grants and loans tied to restructuring and rationalization, and nationalization. Each of these policies will be examined in turn.

Trade Protection One of the factors contributing to the decline of the industry in the early 1970s was the reduction in trade protection afforded the industry. From 1915 to 1956, the industry was sheltered behind a 33.3 percent tariff level; by 1972, the level had decreased to 11 percent (Dunnett, 1980, p. 130). In 1973, the trade barriers protecting the industry were eroded further by the United Kingdom's entrance into the European Community (EC). While reduced tariff barriers in the EC allowed greater trade in automobiles between England and other countries, most of the trade was at the expense of British manufacturers. Under these circumstances, British manufacturers were much less able to exploit overseas markets than were overseas manufacturers able to exploit the British market.

To address the declining level of trade protection offered to the motor-vehicle industry, the government laboured to secure informal commitments from competing countries to restrict imports into the United Kingdom. At the 1975 Rambouillet meeting in France, Prime Minister Wilson successfully obtained agreements from world leaders which would limit motor-vehicle imports into the United Kingdom. Subsequent to the Rambouillet agreement, the British government persuaded the Japanese to restrict the number of motor vehicles destined for the United Kingdom. When informal agreements could not be secured or were not adhered to, the government impeded the importation of motor vehicles by relying on stringent enforcement of technical regulations. In 1977, the EC accused the Labour government of violating community accords by applying such devices to EC motor-vehicle imports (Rhys, 1980, p. 202).

At the same time that it tried to restrict imports, the government also endeavoured to stimulate motor-vehicle exports from the United King-

dom. A major effort in this direction involved government assistance to Chrysler in its successful bid to win a contract to produce Hillman-Hunter cars in Iran for five years (Dunnett, 1980, p. 133). In 1978, the NEB extended aid to British Leyland to bolster export sales of the Mini.

Government Grants and Loans and Nationalization Policies Government policy toward the motor-vehicle industry has also taken the form of extending grants and loans and, in one case, has entailed nationalization. These policies will be examined in the context of two firm studies: British Leyland and Chrysler.

British Leyland Well before the government moved to nationalize British Leyland in 1975, the industry had been the recipient of generous levels of government assistance. BL was the creation of a government-inspired merger between two British motor-vehicle manufacturers in 1968. In that year, motivated by a desire to ensure that at least one British firm would be of a size and strength to compete internationally, the government provided the fledgling company with £25 million (Dunnett, 1980, p. 133). This money was dispensed by the Industrial Reorganization Corporation and was earmarked for rationalizing BL's production.

In spite of the significant infusion of government capital into BL, the firm proved difficult to rationalize. Six years after the merger, BL was offering six basic models, compared to the four offered by Ford of Europe (Dunnett, 1980, p. 134). On average, BL's production runs never exceeded 140,000 units (*ibid.*, p. 136), a figure well below the one million units necessary to realize minimum efficient scale.

To modernize production, BL undertook a half-billion pound investment plan in 1973. The plan turned out to be ill fated when the economy took a nosedive in the same year. After abandoning their modernization plan, BL's directors turned to the government for aid. At the outset, the government extended a £50 million guarantee on BL's overdraft. Further measures would be undertaken after a government task force reported on the long-term prospects of the company.

This report, named after its chairman, Donald Ryder, predicted that BL could become profitable if sufficient capital were made available to the company, and if the company undertook several measures designed to increase productivity. To this end, Ryder recommended that the government purchase all existing BL shares and make available £1.260 million in the form of equity and loans between 1975 and 1980. The provision of generous levels of government aid would be contingent on BL's performance in:

- reorganizing the company into four groups based on product lines;
- cutting employment;
- reducing the number of bargaining units in the industry; and
- promoting greater movement and interchangeability among jobs.

In addition, the Ryder Report stipulated that none of the 55 factories operated by BL was to close (Rhys, 1980, p. 203).

The government adopted Ryder's recommendations without notable modification. BL was nationalized by Act of Parliament, and state control was later passed to the NEB. By 1977, however, the government was coming under intense criticism for BL's lacklustre performance. Although £350 million had been directed to the company between 1974 and 1977, BL was unable to put this capital to profitable use. Between 1975 and 1979, the share of the domestic market it held slid from 32 percent to 20 percent (Rhys, 1980, p. 203). The company was still grossly overstaffed, and it had achieved only negligible improvement in productivity. For the most part, this was attributable to the confrontational stance adopted by labour. Fearing the loss of considerable employment, labour refused to conform to any of the Ryder plan's goals, even when threatened with investment cutbacks. At the same time, the government's direct responsibility for BL prevented it from taking any decisive action which would cut back further investment because such cutbacks would entail effects on employment or balance of payments.

As the failure of the Ryder plan became more glaringly apparent, however, and as North Sea oil revenues began to flow, diminishing concern over the balance of payments, the government decided to abandon the Ryder plan. It appointed a new chairman of BL who promptly initiated a corporate reorganization. Following the appointment, a less ambitious plan for BL was introduced. The plan required the expenditure of £850 million in government aid between 1978 and 1980. By 1979, BL's drain on the NEB was so great that the Board's borrowing powers had to be increased from £1 billion to £3 billion (Rhys, 1980, pp. 202–203).

Why did the Ryder plan fail? Several explanations have been offered. Dunnett suggests that the plan was overly optimistic in its expectations. Given the dismal performance of BL to 1975, it was unlikely that a massive capital infusion could revive an ailing giant within so short a timeframe. The plan's predicted levels of import penetration and employment redundancies illustrated its "hopeless optimism." Moreover, it may have been unrealistic to make stringent demands on labour when history revealed such turbulent and fragile industrial relations.

Chrysler In the mid-1960s, Chrysler acquired the Rootes company with the aid of £3 million from the Industrial Reorganization Corporation (Dunnett, 1980, p. 135). From the mid-1960s to 1980, Chrysler lost over £400 million in the United Kingdom (*ibid.*, p. 139). Despite its dismal performance, the company's repeated requests for government aid were met with unequivocal refusals. In 1975, however, after the company sustained a record £100 million loss in the first nine months, the government was prepared to offer massive amounts of aid to the ailing com-

pany. The government's receptivity to Chrysler's request was based, primarily, on the threatened closing of Chrysler plants in the United Kingdom. The closing of Chrysler would involve the direct and indirect dislocation of 50,000 employees and alienate those regions where Chrysler's operations were concentrated. Faced with a "fearsome choice" and operating with a "pistol to their head," the government gave way to Chrysler's demands and agreed to share up to £72.5 million of Chrysler's losses and guarantee £90 million in loans (*ibid.*). In addition, the government assisted Chrysler to secure lucrative foreign contracts, such as the one obtained in Iran.

The "bail-out" of Chrysler was followed by a period of close cooperation between the company and the government. The company agreed, in 1975, to produce certain components for Chrysler's European operations in the United Kingdom. Later, in 1978, it persuaded the government to increase the level of trade protection accorded the industry. This spirit of close cooperation was shattered, however, in 1979, when Chrysler sold its British operations to Peugeot-Citroen as part of its general retrenchment program.

IMPACT OF INTERVENTION

Despite the massive level of government aid directed to the motor-vehicle industry in the latter part of the 1970s, the industry has continued on its course of decline. By 1982, import penetration had increased to 58 percent of the domestic market; this figure had risen from 49 percent in 1979.⁴ Output of motor vehicles, which amounted to 2,463,000 units in 1972, dropped to 1,416,500 in 1980 (Pollard, 1983, p. 289). This decrease was accompanied by a concomitant 34 percent decline in employment between 1965 and 1980 (*ibid.*, p. 280, Table 7-5).

In terms of these decreases in output and employment, the efficacy of the Labour government's policy toward the motor-vehicle industry is suspect. Government-investment activities were motivated more by political expedience than by sound economic principles. In an attempt to ameliorate short-run economic consequences of uncompetitiveness, the government compromised its desire to effect enduring rationalization and modernization in the industry.

The Steel Industry

BACKGROUND

The steel industry is a major component of the British economy, accounting for 5 percent of manufacturing output and employment, and 12 percent of investment (Cockerill, 1980, p. 134). As in the motor-

vehicle industry, the form and frequency of government intervention has been a central factor in determining the structure of the steel industry. In this respect, one commentator has outlined four distinct stages of industry development that reflect the government's stance on the industry in a given period:

- the acrimonious decade (1945–55), in which a Labour government nationalized the steel industry and, shortly thereafter, a successor Conservative government denationalized the same industry;
- the waiting decade (1955–65), in which industry, although restored to the private sector, was reluctant to commit substantial funds to modernization and investment in case of renationalization;
- the lost decade (1965–75), in which the industry was renationalized, and investment in industry was fatally delayed; and finally
- the last decade (1975–84), in which the extent of steel making in the United Kingdom has contracted significantly (Cottrell, 1981, p. 2).

Among the various development periods that are enumerated above, it is the government's activities in the "lost decade" which do most to explain the current complexion of the steel industry. Briefly, the government's decision, in 1967, to renationalize the steel industry was predicated on the notion that government ownership would ensure that the industry would be restructured and modernized, and that its productivity could be increased (Cockerill, 1980, p. 137). In addition, nationalization would serve as a tool to promote direct involvement in regional development (Cottrell, 1981, p. 46). The government nationalized 14 major steel companies which accounted for 90 percent of industry output, 67 percent of industry employment, and 78 percent of sales in the domestic market (*ibid.*, p. 48). The nationalized steel corporation, known as British Steel Corporation (BSC), became the second-largest producer in the Western industrialized world.

The remaining private industry came into existence by "legislative accident." This is because:

The output threshold laid down in the Nationalization Act of 1967 was designed to capture the principal producers; enterprises with small outputs or which were iron makers or steel rerollers and finishers only were excluded from public ownership. The independent sector was thus formed as a residual . . . and its composition is diverse as a consequence" (Cockerill, 1980, p. 141).

The legislative accident which created the independent industry inadvertently allowed the private sector to retain the most lucrative end of the steel market: the production of alloys and stainless steel. For this reason, the independent steel industry has consistently earned more robust profits than has BSC.

In 1977, about 130 firms constituted the independent steel industry. Of

these, 30 produce and process crude steel; the remainder are rerollers and finishers (Cockerill, 1980, p. 135). The great majority of firms in the industry belong to the British Independent Steel Producers Association. The independent sector is highly concentrated: the four largest manufacturers account for two-thirds of total production (*ibid.*, p. 141). While there has been some entry into the independent industry since 1967, there also has been considerable rationalization. The Industrial Reorganization Corporation has played a major role in promoting the consolidation of independent steel producers. Its policies have ranged from the simple extension of loans to the arranging of the transfer of private firms to the public sector and then returning them in a consolidated form (*ibid.*).

Characterizing the private sector as "independent" constitutes somewhat of a misnomer in view of that sector's historic dependency on BSC's crude steel. The "independent" industry's dependence was highlighted when it suffered severe contraction in the early 1970s because of BSC's inability to supply the sector with sufficient raw material.

Taken as a whole, the performance of the steel industry prior to 1975 was less than spectacular. Although demand for steel was buoyant during the years 1970–73, the lack of investment in the industry over the previous two decades began to hinder its ability to remain competitive. By the end of 1970, growth in British steel production had fallen well behind that of the rest of the world. Steel production in Japan and Spain, for instance, grew by 50.1 percent and 63 percent respectively, between 1967 and 1970, while production in the United Kingdom increased by only 14.4 percent in the same period.⁵ In these terms, the rate of growth in British steel production was "steady but unremarkable"; in 1973, total steel-making capacity was only 8 percent higher than in 1960 (Cockerill, 1980, p. 142).

Dismal growth rates were the by-product of several contributing factors. The low levels of investment in the industry went far toward exacerbating the industry's difficulties; without significant investment, the industry was unable to rectify its problems of aging plants and overmanning. The severity of these difficulties was reflected in the industry's depressed levels of labour productivity. In 1976, it took twice as many person-hours to produce a tonne of steel in the United Kingdom as in almost any other EC country (Cottrell, 1981, p. 111). Nor were the low levels of labour productivity compensated by rising capital productivity.

Although the price of steel rose in the early 1970s, rapid increases in the cost of labour undermined the ability to translate such price increases into increased profitability. The extent of the industry's malaise was accentuated further by declining exports and increasing imports: between 1970 and 1974, imports increased by 61 percent, and exports decreased by 18 percent.⁶ By the mid-1970s, the position of the industry became more precarious as the steel industry's major domestic

buyers, the motor-vehicle and shipbuilding industries, suffered major declines.

GOVERNMENT INTERVENTION

To address the difficulties being experienced by the steel industry, the Labour government, in 1968, unveiled its seven-year plan, which would increase steel output by restructuring and modernizing production techniques. It was expected that the injection of £1 billion would enable the steel industry to produce 33 million liquid tonnes annually by 1975 (Cottrell, 1981, p. 55). The implementation of the plan was stalled in 1970, however, by the incoming Conservative government. Rather than continue to prop up the newly nationalized industry, the Conservatives decided to launch a full-scale review. But it was not until 1973 that the Conservative government announced its 10-year development strategy. In the interim, four crucial years of potential adjustment were lost.

Essentially, the Conservative plan differed from Labour's in two major respects:

- it would cost £2 billion more than Labour's; and
- it stipulated that steel making would be terminated in certain regions of the country.

Aside from these differences, the Conservative plan had as its keystone the same emphasis on modernization and restructuring that was found in the labour program. Moreover, nationalization was perceived to have gone too far to be reversed.

No sooner was the machinery for implementing the Conservative plan being readied when Labour was returned to power. The Labour government immediately imposed a moratorium on the implementation of the plan. The new government was concerned with the 6,000 labour retrenchments that would occur as production in certain regions was wound down. No doubt Labour sensitivity to the retrenchments was enhanced by the location of large blocs of Labour supporters in the areas where the retrenchments were to occur (Cottrell, 1981, p. 58).

To develop an alternative strategy, the government commissioned a review study. This study, the Beswick Review, "sounded the death-knell of the BSC as a potentially profitable and efficient organization" (Cottrell, 1981, p. 57). The Review, which was presented to Parliament in 1975, postponed the impending closures in the regions. In so doing, it had the effect of more than tripling the cost of the 10-year plan (*ibid.*, p. 58). Outdated modes of production were retained, while industry confidence was eroded dramatically.

By 1978, the effect of diminished demand, which had dogged the industry for five years, was making its impact felt. Enthusiasm for industrial expansion was tempered by the realities of a contracting

market for steel products. In this less sanguine spirit, the government adopted the recommendations forwarded in a white paper on the BSC which placed a premium on reducing existing steel-making capacity. Instead of aiming toward a capacity of 36–38 million tonnes, the government envisaged a 16–22 million tonne capacity (Cottrell, 1981, p. 85).

BSC also undertook a role in alternative job creation. In 1973, it set up its own job-creation agency, BSC (Industry) Limited. Initially the job-creation arm of the BSC performed a purely advisory function. By 1977, however, the agency played a more vigorous role. It was empowered to extend comprehensive retraining assistance and financial advice to industry. The latter includes the provision of market research, technical studies, general and strategic consultancy advice and detailed location studies. BSC (Industry) Ltd. also assisted in the promotion and disbursement of regional policy grants, special medium-term loans to cover up to 50 percent of the cost of fixed assets related to projects in steel-closure areas (provided by the European Coal and Steel Community and the European Investment Bank), and factory-construction assistance.⁷

The Thatcher government, which came to power in 1979, was left with the task of managing future closures in the BSC. In the fiscal year 1979/80, BSC lost £545 million after taxes and interest (Grant, 1982, p. 93). To stem the flow of further losses, it announced that in 1980, capacity would be cut back from 21.5 million tonnes to 15 million tonnes and the work force reduced by 52,000; these reductions were designed to confine the losses of BSC to £450 million per year (*ibid.*).

A 13-week BSC strike in March 1980 jeopardized the attainment of that goal. The strike occurred over the issue of redundancies and closures, and it cost the company a further £1,200 million (Cottrell, 1981, p. 123). After the strike was settled, it became clear that to remain viable, BSC would require an additional £400 million in 1980/81 (Grant, 1982, p. 94). Fearing the social and economic disruption of bankruptcy, the government acquiesced. Even with the termination of 10,000 jobs and the reduction of 600,000 tonnes of capacity, a further £850 million in government aid was required to keep the company alive in February 1981 (*ibid.*). This last grant meant that by 1982 the BSC had received over £2,550 million in total assistance since its establishment.

Government intervention in the steel industry is constrained by commitments entered into with EC-member states. The Davignon Plan, which was implemented in 1977, at the request of France, the United Kingdom and Italy, established a system of minimum prices for steel products, which would be operative when the market was particularly depressed, and guidance prices for all steel products. In 1978, voluntary production quotas were negotiated with EC steel firms. These quotas were strengthened by a system of compulsory quotas, fines, and inspections following the 1980 world-price collapse in steel. EC steel producers are also protected by an “effective” tariff of approximately 12 percent,

although the common external tariff on steel products is only 5 to 7 percent. The protectionist features of the regime have been enhanced by voluntary restraint agreements which have been negotiated on steel exports from a number of nations, including Japan. Although a 1985 deadline was established by the steel industry for ending subsidies, production quotas and minimum prices in the EC, the European Commission has recently proposed lifting only minimum price controls, but retaining other protective measures.⁸

IMPACT OF INTERVENTION

Despite a massive infusion of government investment in the latter half of the 1970s, the steel industry has continued to be plagued by serious decline. Steel imports into the United Kingdom increased by 17 percent between 1974 and 1978, while steel exports decreased by 18 percent in the same period (Cottrell, 1981, p. 65). Expressed in different terms, the share of the domestic market held by British manufacturers slipped from 95 percent in 1969/70 to 80 percent in 1978/79 (*ibid.*, p. 68). Mirroring these changes, both output and employment in the industry dropped in the 1970s; crude steel production fell from 27.9 million tonnes in 1970 to 11.4 million tonnes in 1980, while employment, which stood at 208,000 in 1977 declined to 100,000 in 1982 (Pollard, 1983, pp. 294–95). Even though industry employment was reduced markedly, labour productivity declined by 9.5 percent between 1970/71 and 1979/80 (Cottrell, 1981, p. 108).

The Shipbuilding Industry

BACKGROUND

As indicated by its share of manufacturing output or employment, the British shipbuilding industry hardly seems worthy of the energy and money that the government has expended on it. In 1971, the 12 major shipbuilding companies would have ranked as 56th in shipments and revenue and 123rd in capital employed if considered as a single company (Hogwood, 1979, p. 17). Moreover, these 12 companies employed only .25 percent of the total working population (*ibid.*). Yet these bare statistics do not capture the high concentration of the industry in politically sensitive regions. Most of the industry is located within government regional development areas. In 1964, shipbuilding employment in development areas ranged from 1.1 percent to 15 percent of total employment (*ibid.*, p. 18, Table 1.2). In this respect, any change in the fortunes of the shipbuilding industry has entailed significant effects for employment in underdeveloped regions.

The concentration of the industry in government development areas reflects an earlier desire on the part of shipbuilders to be located in close

proximity to the raw materials necessary for manufacture. Recently, reduced transportation costs have eroded this locational advantage. Now the ongoing presence of the industry in special development areas is motivated, in part, by the strong incentive effects of continuous regional development assistance.

Although the absolute level of output in the industry has remained relatively constant, when measured in an international context its decline has been stark. In 1947, for instance, 1,213,000 gross registered tonnage (grt) of ships were delivered by the British industry, or 48.9 per cent of the world total; in 1966, 1,084,000 grt were delivered, or 3.7 per cent of the world total (Hogwood, 1979, p. 23, Table 1-4). Simply put, the British shipbuilding industry has ceased to be a major manufacturer of ships and is now only of secondary importance in the world market.

The decline of English shipbuilding is a product both of the myopic vision of government, business and labour interests in the United Kingdom and of shifting comparative advantage. At one time, British shipbuilders had a formidable grasp on the world market, but because they undertook only scant investment and failed to innovate at a pace set by their competitors in Japan, South Korea and Brazil, the British share of world market began to erode. By 1977, British performance was so dismal that government found it necessary to nationalize 27 firms in the industry.

GOVERNMENT INTERVENTION

Like the British motor-vehicle and steel industries, shipbuilding has not suffered from a dearth of government aid. As early as 1964, the current difficulties of the shipbuilding industry were being foreshadowed by falling levels of output; in 1955, the industry held 26.6 percent of the world market, but by 1964, this figure had dropped to 8.3 percent (Hogwood, 1979, p. 23). To examine the deficiencies that existed in the shipbuilding industry, the Labour government set up an independent committee under the chairmanship of a rubber-manufacturing executive.

In 1966, the committee reported. Its recommendations called for the restructuring of the industry into four or five regionally based groups. The restructuring would be directed and promoted by a government-financed agency, the Shipbuilding Investment Board (SIB). To encourage the restructuring of industry, government financial assistance would be made available in the form of grants, loans and guarantees on purchaser contracts. Such assistance, however, would be contingent on the industry undertaking changes in its structure and improving its performance. By adopting the proposals contained in the report, the committee predicted that British shipbuilders would be able to recapture a world-market share of 12½ percent (Hogwood, 1979, p. 84).

The *Shipbuilding Industry Act*, which was enacted shortly after the

committee reported, embodied substantially all of the proposals outlined in the review. Based on this legislation, the government embarked on a drive to consolidate many of the shipyards into regional groups. The newly formed SIB was instrumental in arranging the merger of five shipyards into the Upper Clyde Shipyards (UCS). It made £7 million in loans available to the company for restructuring. In addition, the government agreed to purchase 17½ percent of the equity in UCS (Hogwood, 1979, pp. 101–102). The SIB also engineered the consolidation of shipyards in the regions of the Lower Clyde and the Tyne.

The SIB envisaged that the new regional shipyards would be conducive to modernization and rationalization. The new enterprises were seen as providing an “opportunity for new management structures and new attitudes” to evolve (Hogwood, 1979, p. 112). In fact, the groups “became massive rescue operations with the SIB desperately trying to include yards whose survival was doubtful” (*ibid.*). Indeed, of the substantial amounts of aid made available to the UCS, little was used to improve facilities, expand working capital, or meet the costs involved in merging five firms into one. Rather, the aid constituted a windfall gain to the previous shareholders of the firm (*ibid.*, p. 135).

The SIB’s role was not limited merely to promoting mergers in the shipbuilding industry. Once a group of firms had been consolidated, or even if a firm resisted consolidation, the SIB was charged with the responsibility of dispensing government aid to it. On the surface, the agency’s aid seemed tied to rationalization, but as with the consolidation grants, the massive amounts of government aid funnelled to the industry were indeed unconditional. Assistance was provided when shipbuilding firms were in danger of failing. More often than not, shipbuilding companies found themselves in the red because of rising cost pressures on fixed-price contracts. Once the money had been doled out, the SIB’s involvement was minimal; no attempt was made to direct the use of the allocated funds that the firms received. By the end of 1969, UCS had been the recipient of over £17 million in aid (Hogwood, 1979, pp. 117–18).

By the time the Conservatives took over the reins of government in 1970, the SIB had spent over £40 million in the form of grants and loans (Hogwood, 1979, p. 135). In addition, the government had directed large sums of money to British shipowners as investment grants for the purchase of new ships; by 1969, more than £75 million had been allocated in this fashion (*ibid.*). Slightly less than half of this money went to foreign-controlled firms, and about one-fifth went to indirect subsidies for ships built outside the United Kingdom (*ibid.*, p. 126). The government also guaranteed loans extended to British shipowners who had contracted for British-built ships; by 1970, £600 million in contracts had been guaranteed (*ibid.*, p. 124).

As a response to the growing involvement of the Labour government in British industry generally, the Conservatives came to office in 1970

committed to a policy of "non-interventionism." That commitment was tested when UCS collapsed in June 1971. The collapse was precipitated by a £28 million loss (Hogwood, 1979, pp. 152–53). While the company was being liquidated, union officials at all levels commenced a vigorous campaign to save it. Soon after the collapse, a government-appointed advisory group recommended that efforts be focussed on salvaging Govan, only one of the four yards of UCS. The report also called for the immediate dismissal of 400 employees (*ibid.*, p. 155).

The union reaction to the proposal was swift and militant: the UCS's Clydebank yards were taken over by workers. Following a protracted confrontation, the government yielded to the workers' demands and undertook direct responsibility for ensuring the viability of three of the four yards; it also pledged to try actively to find a buyer for the fourth. Essentially, the government's promises "constituted an undertaking . . . to commit very sizeable sums of money to keeping the UCS work force employed at their existing workplaces" (Hogwood, 1979, pp. 159–60). This required an immediate injection of £35 million into the newly constituted Govan shipyards (*ibid.*).

Why did the government retreat from its non-interventionist stance and capitulate to the unions' demands? Undoubtedly, it was concerned with the economic and social implications of a closure of the shipyards in a fragile regional economy. At the time of the collapse, Glasgow, which is located near the UCS shipyards, was suffering from unemployment levels twice the national average (Hogwood, 1979, p. 161). In these circumstances, the fears of civil disorder loomed large in the government's decision to save the yards.

The government also abandoned its non-interventionist posture when it made generous levels of assistance available to the Harland and Wolff, and Cammell Laird shipyards. These bail-outs revealed that the government's ostensible commitment to non-interventionism was unlikely to prove resistant to intense political pressure. When such pressure was exerted, the Conservative government reacted in the same ad hoc manner as had its Labour predecessor. In so doing, it sacrificed non-interventionism to political expediency. Indeed, the Conservative government found itself doling out large amounts of aid which were virtually unconditional.

By mid term, the Conservative government established a comprehensive apparatus which would enable the government to mete out assistance in a more rational fashion. A general grant scheme was introduced for all ships constructed that were larger than 100 gt. Initially, grants would be offered at 10 percent of contract value in 1972, and would undergo successive annual reductions until they reached 3 percent in 1974 (Hogwood, 1979, p. 165). The Conservative government also commissioned a study on the state of the shipbuilding industry to be carried out by a team of management consultants. The findings of the

Booz Allen Report, published in 1975, were not particularly surprising: problems such as undercapitalization, poor management, variable product quality, delays in product delivery, overcapacity, and archaic production techniques were found to be widespread in the industry. By international standards, the industry was grossly inefficient and uncompetitive. Moreover, the Report suggested that even with continued government assistance, the industry would sustain severe retrenchments of labour in the future. The Report found that the difficulties of the industry could be ameliorated only with additional government assistance which would enable the industry to meet its operational losses and replace working capital.

The validity of the Report's findings was emphasized by succeeding events. In 1974, an incoming Labour government was confronted with an industry that was mired in debt and crumbling under the burdens of inefficiency. It undertook rescue operations for the major British shipbuilders. The new Govan Shipyards (the successor to UCS) reported ongoing losses, despite the infusion of large amounts of government aid. In 1975, the government, motivated by concern over "the 5320 jobs that [Govan] provides in an area of exceptionally high unemployment," decided to furnish the shipyard with an additional £6.9 million in loans and £10.3 million in grants (Hogwood, 1979, p. 184). The provision of this money was predicated on the assumption that Govan would be profitable by 1978. The government also assisted Cammell Laird in the amount of £6.5 million in the same period (*ibid.*, p. 181).

The involvement of the Labour government was not limited to offering grants and loans. In 1975, the government moved to nationalize two shipbuilders: Courtline, and Harland and Wolff. The nationalization of these firms was consistent with the Labour Party's election platform. Courtline was taken into public ownership after suffering repeated shortages of capital in the early 1970s. Harland's difficulties were tied to the collapse of the oil-tanker market, which followed on the heels of the Yom Kippur war. Harland's nationalization was the culmination of the company's long history of receiving government aid: £59 million between 1946 and 1975 (Hogwood, 1979, p. 103). The Labour government supplemented firm-specific measures with a number of general assistance policies. These programs ranged from temporary employment subsidies to government purchasing commitments. Yet, even with this aid, the industry did not engage in significant restructuring. By 1977, the combined effect of a supportive political climate and stagnating industry output provided an opportunity for the Labour government to make good on its election promise of nationalizing the industry. After prolonged debate and negotiations, the *Shipbuilding Industry Act* was passed. The legislation effectively nationalized 27 companies. These companies comprised the major shipbuilders of the United Kingdom.

The legislation provided that a corporatist approach be employed in

the management of the shipbuilding industry. Government, trade unions and shipbuilders would be charged with the responsibility of administering shipbuilding policy, including the allocation of state aid. Importing a corporatist approach into the management of the industry was designed to overcome management-labour dissension by instilling greater industrial democracy. By the following year, British Shipbuilders (BS) employed some 86,000 workers and made sales of £548 million (Hogwood, 1979, p. 103).

IMPACT OF INTERVENTION

Contrary to the expectations harboured by the government at the time of nationalization, British Shipbuilding has been plagued by the same difficulties that hindered its predecessors. Nationalization did not serve as a panacea for an industry beset by rampant inefficiency. In its first year of operation, BS lost £108 million and was contemplating reducing its work force by 12,300 persons and its capacity by 32 percent (Hogwood, 1979, p. 204). Moreover total industry output, which had declined only in relative terms since World War II, experienced an absolute decline of close to 60 percent between 1977 and 1980 (Pollard, 1983, p. 297).

The Coal-Mining Industry

BACKGROUND

For the British coal-mining industry the period prior to World War I was the "age of success" (Jackson, 1974, p. 5). Coal dominated the world's energy market, and Britain had a secure place in this market: in 1913, Britain produced 50 percent of Europe's, and 20 percent of the world's, coal and was the leading coal exporter. Between 1888 and 1913, coal production had increased dramatically from 170 million tons to 287 million tons, and employment in the coal-mining industry increased from 439,000 to 910,000 persons. Profits rose from £11 million in 1890, to £28 million in 1913 (ibid.).

From 1913 to 1939, the British coal-mining industry declined dramatically, production fell from 287 million tons to 236 million tons (Jackson, 1974, p. 35). It was affected, as were other industries, by the Great Depression of the inter-war years. Moreover, coal faced increasing competition from new sources of fuel. In the same years employment in the coal-mining industry dropped from 1.1 million to 800,000 persons (ibid.). Britain retained its share of the declining world export trade in coal until the mid-1920s when competition from European and American coal producers increased (Griffin, 1977, p. 171). In 1939, only 46 million tons of coal were exported as compared to twice that amount in 1913 (Jackson, 1974, p. 35).

From 1939 to 1957, with re-armament, wartime, and the postwar boom, demand for coal was high, since coal was still the principal fuel of industrialized nations. Output declined during the war, falling to 204 million tons in 1942 and 175 million tons in 1945 (Griffin, 1977, p. 173). This was partly the result of the loss of 80,000 young mineworkers to the armed forces, declining productivity, and shortages of materials. By 1957, output was 199 million tons, and employment in the coal-mining industry had dropped to 704,000 workers (*ibid.*, pp. 173–74).

In 1956/57 circumstances changed, when much cheaper oil began to make inroads into coal's traditional markets (Griffin, 1977, p. 175). To meet this competition the coal industry had no option but to hold down prices, which entailed reducing the average cost of production. This restraint was achieved by closing uneconomic pits, concentrating on fewer coal faces per mine, reconstructing old collieries, increasing mechanization and holding down wage costs (*ibid.*, pp. 175–76). From 1956 to 1970, the number of pits in operation dropped from 840 to 299 (Jackson, 1974, p. 195, Table 18), and in roughly the same time period the number of coal faces being mined dropped from 4,800 to 830.⁹ From 1960 to 1972/73, the percentage of power-loaded coal increased from 23 percent to 97.7 percent (Griffin, 1977, p. 176). In the same years coal production dropped from 199 million tons to 130 million tons, and employment in the coal-mining industry declined from 704,000 to 264,000 workers. Despite these changes, increased concentration and mechanization caused the level of productivity in the coal-mining industry almost to double from 1957 to 1972/73 (*ibid.*).

The 1974 plan for coal foresaw that commodity as having a greater part in satisfying energy requirements. The plan — a response to the quadrupling of oil prices in 1973–74 that was devised by a Labour government elected in the wake of a coalminers' strike which brought down the Conservative government — sought to shift production from uneconomic mines to more viable mines and to increase output at economic mines. Between 1975 and 1983, 60 collieries were closed (Bailey, 1983, p. 21). The number of miners affected was 21,597, of whom 14,864 were transferred to other collieries, and 5,670 were made redundant (*ibid.*). Under this plan coal production and productivity have increased: from 1979 to 1980/81, output increased from 122 million tonnes to 130 million tonnes, and productivity increased from an overall average of 2.25 tonnes per man-shift in 1979, to 2.38 tonnes per man-shift in 1981 (*ibid.*, p. 18).

Coal production has been increased, however, at a time of falling demand. Coal slightly increased its share of the British energy market from 36.4 percent in 1979, to 37.3 percent in 1981, but during this period demand for its products fell by 11.4 million tonnes. The resulting surplus is estimated at 9 million tonnes a year (Bailey, 1983, p. 18).

There are various reasons for the declining demand for coal. A major

reason is that coal prices are relatively high. Such prices discourage conversion to coal by potential users and encourage conservation by present users; non-nuclear power-stations, for example, increased thermal efficiency by 30 percent from 1955 to 1977 (Thomas, 1980, p. 64). Moreover, because of the price of British coal, British coal producers have faced increased competition from coal producers in China, Australia, the U.S.S.R., South Africa, and Poland (Bailey, 1983, p. 21). Another reason for the decline in the demand for coal is the declining product demand of industrial users. Apart from the Central Electricity Generating Board (CEGB), all markets for coal have contracted. Railways and gas companies no longer use coal, the recent recession has decreased demand for coal in the "smokestack industries" (Thomas, 1980, pp. 63–64), and the new high-technology industries consume less fuel (Bailey, 1983, p. 21). Moreover, CEGB demand for coal is expected to decrease as the board fulfils its commitment to a major nuclear construction program (James, 1982, p. 186). A final factor in reducing the demand for coal is the possibility that supplies may be interrupted by industrial disputes that have persistently beset the industry.

GOVERNMENT INTERVENTION

Government intervention in the coal-mining industry falls into two distinct time frames: intervention before and after nationalization of the coal-mining industry in 1947. Prior to nationalization, government actions relating to the coal-mining industry were ad hoc and tentative in nature (Jackson, 1974, p. 36). During the two World Wars, for example, the British government was concerned to maintain coal supplies, but the industry was left to organize itself for the war effort. Only when the coal-mining industry clearly failed to do so did the government intervene; it then assumed control of the industry, but left ownership in private hands (*ibid.*, pp. 10, 46).

After World War I, the coal-mining industry's decline became apparent, but the British government seemed undecided in its policy approach. Between 1918 and 1926, it set up four major inquiries into the coal-mining industry, though it did little to implement the recommendations of these inquiries, which included nationalization.

The coal-mine owners argued that the industry's problems were the result of excessive costs caused by high wages, and they sought reductions in wage levels. Mineworkers resisted such reductions and argued that most of the industry's problems arose from poor organization. The dispute resulted in the General Strike of 1926. After this strike the British government's policy objectives seemed clearer. It supported the reorganization of the coal industry, and legislation was passed to encourage this enterprise.

Under the 1926 *Mining Industry Act*, facilities were provided for the

preparation of amalgamation schemes which, despite the opposition of one of the parties, could be made binding by the Railway and Canal Commission. The Act had relatively little effect because, although it removed impediments to amalgamation, it left the initiative to the industry itself. The industry seemed more interested in cooperative marketing and selling schemes than in amalgamations (Jackson, 1974, p. 27).

In 1930, the *Coal Mine Act* established a Coal Mines Reorganization Commission (CMRC), consisting of five commissioners appointed by the Board of Trade, to promote amalgamations where these arrangements appeared to be in the "national interest" (Jackson, 1974, p. 28). Schemes for amalgamation proposed by the Commission were to be dealt with under the provisions of the 1926 *Mining Industry Act*. The 1930 Act was ineffective for three reasons. First, another part of the Act provided for quotas for individual mines; these quotas encouraged the retention of marginal and unprofitable coal mines (*ibid.*). Secondly, the Act stipulated that the Railway and Canal Commission not endorse any scheme presented by the CMRC that would be financially injurious to any enterprises proposed for amalgamation. This requirement was strictly interpreted by the courts and extremely difficult to comply with. Thirdly, the majority of coal-mine owners disliked the Act and were reluctant to facilitate its application (*ibid.*, p. 29).

Under the 1938 *Coal Act*, the duties of the CMRC were taken over by a new body, the Coal Commission. This Commission was given increased powers to investigate the desirability of amalgamations. If the Commission was convinced that an amalgamation should be carried through, but believed that its powers were insufficient to effect the proposed arrangement, it could apply to the Board of Trade for an extension of its powers. The Act had little effect, in part because its provisions were still insufficiently binding, and in part because of the intervention of the war (Jackson, 1974, p. 31).

In 1945, the Reid Committee, which had been set up to advise on what technical changes were necessary to increase efficiency in the coal-mining industry, reported. The Reid Report concluded that the technical improvements that were essential could not be brought about unless the coal-mining industry were completely restructured. The report stopped short of recommending nationalization, but its conclusions were used effectively by those who supported such actions, including the Labour Party. When the Labour Party was elected in 1945, nationalization of the coal-mining industry was certain. Nevertheless, in a last-ditch effort to avert that step, the coal-mine owners proposed their own scheme of rationalization of the coal-mining industry; that scheme is commonly known as the "Foot Plan."

In 1947, the British coal-mining industry was nationalized. Since then, the key players in the development of coal-mining industry policy have

been the National Coal Board (NCB), the British government, and the National Union of Mineworkers (NUM).

In 1979/80, the NCB had a turnover of £4.7 billion and employed 233,000 workers, making it one of the largest commercial organizations in the United Kingdom (James, 1982, p. 182). Its business is divided into coal-mining, coal products, and ancillary activities such as distribution, but coal-mining accounts for 80 percent of its turnover and 96 percent of its employees (Thomas, 1980, p. 59). Since 1947, the NCB has been the largest coal producer in the Western world. Underground mining, accounting for 90 percent of output, is decentralized to 12 mining areas, each controlling a number of collieries (James, 1982, p. 182). Responsibility for opencast mining rests with an Opencast Executive which sub-contracts the physical operation of sites.

While the NCB oversees the day-to-day operations of the coal-mining industry, it also formulates long-term plans for the industry, based on projected demands for coal, in consultation with the government and NUM officials. In 1950, the NCB devised a plan to reconstruct the coal-mining industry, based on projections of increased demand for coal in the 1960s. Although this plan was revised in 1956, the assumption of expansion remained. The NCB embarked on a massive campaign of investment that involved shifting production to profitable existing, reconstructed or new collieries and increased mechanization of coal-mining operations.

With the decline in demand for coal from 1956/57, the NCB revised its plan for the coal-mining industry in 1959. The investment plan was scaled down so that while there would be future mine closures, these closures would not be offset by expansion of old mines or the opening of new mines. Because of a severe reduction in coal consumption in 1964, the program of colliery closures was accelerated in 1965.

In response to the 1973 oil crisis, the NCB devised a new plan for the development of the coal-mining industry. The 1974 "Plan for Coal" was agreed to by a tripartite group of management, labour and government. It forecast increased demand for coal, as high as 150 million tons a year by 1985 (James, 1982, p. 182), and called for massive new investment first to stabilize, then to increase mining capacity over the decade. This advance was to be achieved by closing uneconomic mines, opening new mines, and increasing output at profitable existing mines. In the long term, these changes were expected to increase productivity; in the short term, wage incentives were offered to achieve this result. In practice the 1974 plan has proved unrealistic, as demand for coal has decreased, not increased as forecast.

The NCB has not been autonomous in setting the direction of the coal-mining industry. The British government has exerted influence through its appointments to the NCB, its control over NCB finances, and its

policy directives. The relationship between the NCB and the government, however, is not clear. As R.B. Thomas notes:

The NCB is subject to continuous political pressures arising from social, regional and other issues but the NCB-government relationship, which should be characterized by trust, continuity, and accountability is ill-defined. A framework of institutions and criteria for agreements on long-term objectives is still lacking. This is a serious obstacle to sensible decision making, though the government has now acknowledged the importance of specifying objectives" (Thomas, 1980, p. 59).

The objectives of the British government with regard to the coal-mining industry have not been defined clearly. At times the government has pressed hard for rationalization of the coal-mining industry. At other times, sensitive to the regional implications of pit closures, it has retarded rationalization of the coal-mining industry.

In the 1960s, the British government pressed the NCB to contract the coal-mining industry at a pace faster than the NCB considered necessary; government projections of future demand for coal were lower than NCB projections, and in the end the NCB was forced to accept these projections. Under the 1974 Plan for Coal, the British government supported further rationalization of the coal-mining industry. The NUM's threat of strike action over closure of loss-making pits caused the government to shelve plans to close these pits in 1981; strike action over the same issue in 1984 did not, however, have the same effect.

The British government has been aware of the difficulties involved in dismissing considerable numbers of coalminers, especially since such miners are traditionally recruited from isolated communities where there is little or no alternative employment (Jackson, 1974, p. 2). The government has both cushioned the effects of rationalization, through such measures as redundancy and relocation payments, and sometimes, too, slowed rationalization by delaying pit closures,¹⁰ giving the NCB direct financial aid,¹¹ relieving the NCB of some financial obligations,¹² restricting coal imports,¹³ taxing other fuels,¹⁴ and subsidizing the use of coal in other nationalized industries.¹⁵

The National Union of Mineworkers represents most workers in the coal-mining industry. It influences policy making both through a system of worker consultation and by means of threats of strike action. The system of worker consultation is one of the most advanced in the United Kingdom. At the national level the NUM, NCB and government meet in tripartite sessions to determine future policy for the coal-mining industry. This "panel" is paralleled by a Joint Policy Advisory Committee of NCB and NUM representatives which meets regularly to discuss current results and future plans. There are also consultative committees at area and colliery levels.

The NUM-NCB relationship was very close until the 1970s. The NUM supported the NCB both in the period of expansion until 1959 and in the

period of contraction that followed. NUM support for the NCB was based on the NUM's desire to see a nationalized coal-mining industry work. One reason that the NCB retained union support after 1959 was its attempt to maintain production targets, despite government pressure to lower these targets. Maintaining production targets would not have prevented decline in employment levels, since productivity increases were projected, but it would have slowed the process (Jackson, 1974, p. 171).

The NUM's support for the policy of rationalization of the coal-mining industry came to an end in the early 1970s, when it became apparent that coalminers were worse off than ever before. Employment in the coal-mining industry had declined dramatically, and wage levels were relatively low; miners fell from third place in the national earnings table in 1960, to twelfth place in 1970 (James, 1982, p. 184). The frustrations of miners were expressed in the strikes of 1971/72 and 1973/74. After the 1973/74 strike, when the Labour Party was returned to power, the coalminers became one of the most secure and highly-paid sections of the British labour force and, until recently, industrial relations improved.

The issue of pit closures has become a dominant problem in relations between the NUM and the NCB, as reflected in the recent year-long strike over the issue. The NCB shelved plans to close uneconomic pits in 1981, in the face of strike action, but went ahead with its plans in 1983/84. In 1983/84, capacity was cut by 4 million tonnes a year; this cut resulted in the closure of 20 pits and the loss of 20,000 jobs. The NCB proposed a further cut in capacity of 4 million tonnes to 97 million tonnes a year for 1984/85 ("Coal," 1984).

The NUM, led by Arthur Scargill, took strike action in March 1984, over proposed cuts in capacity. Its demands included no closures of loss-making pits, the bringing in of 40 million tonnes of new annual capacity, and the speeding up of projects for new uses of coal ("At Least They Met," 1984). The NCB, headed by Ian MacGregor and supported by the Conservative government of Prime Minister Margaret Thatcher, remained committed to closing uneconomic pits. A year-long strike ensued at an estimated cost of £5 billion to the British economy ("Miners," 1985). The NCB successfully maintained its plan to discontinue benefits to uneconomic pits while ensuring that either voluntary retirement benefits or transfers to other employment would be made available to displaced workers. The resolution of the strike was a victory for the Thatcher government, which demonstrated that it could resist successfully the union militancy that the NUM mobilized to defeat an earlier Conservative government under Prime Minister Edward Heath.

IMPACT OF INTERVENTION

Nationalization of the coal-mining industry has facilitated the formation

of long-term plans for the industry. The problem with these plans, however, is that they have been based on long-term forecasts of the demand for coal which have proved inaccurate. In the 1950s, the downturn in demand that occurred in the 1960s was not foreseen, nor in the 1970s was the downturn in demand foreseen that occurred in the 1980s. Implementation of the Plan for Coal pushed up production at a time of falling demand. The NCB has been producing a surplus of 9 million tonnes of coal a year, and the cost of holding accumulated stocks is over £300 million a year (Bailey, 1983, p. 18).

Coal-mining industry policy has been directed at minimizing the share of old inefficient pits and maximizing the share of modern, more efficient pits. Despite these aims, the NCB has suffered losses in most years since the mid-1960s (Thomas, 1980, p. 69). In 1982/83, it sustained a net loss estimated at between £100 million and £115 million, even after the £386 million deficit grant it received from the government to cover reported profit losses ("Coal Board," 1983). In all, subsidies and loans to the coal-mining industry amount to £1.3 billion a year ("Training," 1984, p. 47).

Coal-mining industry policy has been sensitive to the social and regional implications of rationalizing the industry. At times the government has acted to cushion the effects of rationalization or to slow rationalization itself. The policy approach, therefore, has not been clear. Whether the NCB should aim for economic efficiency and let the government cushion the social consequences, or whether it should consider social consequences along with economic efficiency has been difficult to resolve.

The Textile Industry

BACKGROUND

The British textile industry is complex, as it makes use of both natural and synthetic fibres, and a complicated chain of production that involves turning textiles into clothing or household or industrial goods (Shepherd, 1983, p. 26). Within the textile industry, moreover, there are distinct branches: the cotton and wool industries that spin, weave and finish textile fibres, and the knitting industry that produces cloth or finished knitwear (*ibid.*).

In 1960, British fibre consumption included 37 percent cotton, 32 percent wool and 31 percent synthetic fibres; in 1981, these percentages were respectively 10, 17, and 70 ("Rays of Hope," 1984, p. 67). While synthetic fibres now dominate British fibre consumption, the focus of attention here will be on Britain's cotton industry. This industry has felt the impact of low-price import competition much more than have other textile products, and government adjustment measures have concentrated on its problems (Miles, 1976, p. 186).

The relative importance of the textile and clothing industries to British manufacturing is plain in view of the shares of these industries in total manufacturing production and manufacturing employment. In 1963, textiles accounted for 6.5 percent of manufacturing production and 9.1 percent of manufacturing employment, and clothing accounted for 2.6 percent of manufacturing production and 4.7 percent of manufacturing employment (OECD, 1983b, p. 15). By 1977, textiles accounted for only 4.5 percent of manufacturing production and 6.6 percent of manufacturing employment, and clothing accounted for 2.2 percent of manufacturing production and 4.5 percent of manufacturing employment (*ibid.*).

The decline of the British textile industry is best reflected in output, employment and trade-balance statistics. From World War II until 1973, textile output grew (Shepherd, 1983, p. 31). Since 1973, output has declined: in 1981, output was only 64 percent of the level of output in 1973 (*ibid.*, p. 30).

In terms of employment, the decline of the British textile industry has been even more persistent. In the periods 1963–70, 1970–73, and 1973–79, the average annual growth rates of employment in the textile and clothing industries were –3.3 percent, –2.3 percent and –3.0 percent respectively (OECD, 1983b, p. 70). Employment in the textile industry almost halved from 720,000 workers in 1963, to 393,000 in 1980 (Shepherd, 1983, p. 30). Since 1980, a further one-third of the textile-industry work force has been made redundant (“Rays of Hope,” 1984, p. 67). Whole textile mills have shut in the industry’s heartlands, in Scotland, Lancashire and the English Midlands (*ibid.*). Courtauld’s, Britain’s largest textile firm, has reduced its work force by 43 percent to 56,336 employees since 1979. Illingworth Morris, the largest woollen manufacturer, has reduced its work force by 63 percent to 4,000 since 1979 (*ibid.*, p. 68).

Growth in labour productivity resulting from the introduction of new technology has been a major cause of growth in unemployment in the textile industry. In the periods 1963–70, 1970–73, and 1973–80, output per employee in the textile industry increased by 1.2 percent, 5.6 percent, and 0.9 percent, and output per employee in the clothing industry increased by 0.0 percent, 5.6 percent and 1.5 percent (OECD, 1983b, p. 82). Since 1980, output per worker in the British textile industry has increased by about 25 percent. Rapid technological developments are reducing the need for labour; new machinery can lay out and cut cloth and work out the most efficient pattern, and computers enable machines to knot complicated designs (“Rays of Hope,” 1984, p. 67).

Increased import penetration is another factor contributing to unemployment in the textile industry. The share of imported woven cotton and synthetic fibre cloths consumed on a weight basis increased from 31 percent in 1962 to 68 percent in 1979 (OECD, 1983b, p. 56). Although low-cost (low-wage) countries are often blamed for this import penetration,

in fact, in 1980, the share from low-cost countries was 29 percent, while the share from other European Community (EC) countries was 30 percent (Shepherd, 1983, p. 32). Recently there are signs that British fibre consumption is increasing at the expense of imports ("Rays of Hope," 1984, p. 67).

The poor output and employment performance of British textiles reflects declining trade balances (Shepherd, 1983, p. 32). In 1973, Britain's net trade in textiles was \$0.19 billion, and its net trade in clothing was \$ - 0.38 billion. By 1979, net trade in textiles had slipped to \$ - 0.78 billion and that in clothing to \$ - 0.95 billion (OECD, 1983b, p. 100).

GOVERNMENT INTERVENTION

Throughout the postwar period, the major policy emphasis of the British government has been on the protection of textiles and clothing through both tariff and, especially, non-tariff measures. This emphasis has been adopted because imports have been regarded as the cause of domestic market erosion, and because trade-protection instruments operate quickly and are easily administered (OECD, 1983b, p. 100).

After World War II, imports of cotton textiles from non-Commonwealth countries were made subject to duty, applicable at different rates for yarn and cloth, but imports from Commonwealth sources were duty free (Miles, 1976, p. 187). Imports from Commonwealth sources, especially India and Hong Kong, increased rapidly after the Korean War boom. By 1958, imports of cotton cloth exceeded exports, and the cotton industry pushed for greater protection (Briscoe, 1971, p. 87). In 1959, the British cotton industry and the industries of Hong Kong, India and Pakistan agreed to "voluntary limitations" on exports. These limitations, originally intended to last two years, were regarded as providing a "breathing space" during which the industry could reorganize (Miles, 1976, p. 189).

During the following years, the cotton industry continued to push for protection, and between 1959 and 1965, the government agreed to extend "voluntary limitations" to an increasing number of countries (Miles, 1976, p. 193). A global quota system, which effectively applied to all countries outside Western Europe, North America and Australia, lasted from 1966 until the end of 1972. It applied to yarns, woven fabrics and made-up goods containing more than 50 percent cotton by weight. In 1973, the global quota system was replaced by a system allocating specific quotas to the countries involved; these quotas were established at levels reflecting past export levels (*ibid.*).

In 1969, the British Textile Council proposed the replacement of the quota system by a tariff on imports from Commonwealth countries, in order to stimulate changes in production patterns in favour of goods in which the British industry would have a comparative advantage (Miles,

1976, p. 194). Although a tariff was introduced in 1972, the quota system was also retained. It was politically expedient, in the short term, to guard against rising unemployment in the cotton industry, and it was contemplated that quotas would have to be reimposed in 1973, when Britain joined the EC (*ibid.*, p. 195).

The successive rounds of tariff cuts negotiated under the General Agreement on Tariffs and Trade (GATT) have not affected textiles and clothing to the same extent as they have other products (Briscoe, 1971, p. 89; OECD, 1983b, p. 101). An exception to this statement is the Generalized System of Preferences (GSP) which, in principle, suspends the application of tariffs to imports from developing countries. Many exceptions to the GSP, however, involve textiles and clothing (OECD, 1983b, p. 101).

Non-tariff restrictions within the context of various international agreements negotiated under GATT remain the most important form of protection. The original Long Term Arrangement for International Trade in Cotton Textiles (LTA) was in force for five years, beginning in 1962. The LTA was twice renewed, and it was replaced, in 1974, by an agreement that covered all major textile fibres, the Multi-fibre Arrangement (MFA). The MFA was renewed in 1978, and implemented a system of global control in the EC; this system was negotiated by the EC, but based on bilateral quotas and administration. In 1982, the MFA was extended until 1986; under its renewed terms, the EC obtained more restrictive conditions. These non-tariff restrictions, originally regarded as temporary measures to allow textile firms in Britain and other industrialized countries to adjust, have become semi-permanent measures.

Trade policies, although important for the textile sector, have not been the only form of intervention by the British government. Various non-trade measures have been introduced to promote restructuring of the textile industry along more competitive lines. The industry's traditional structure has involved a large number of small and medium-sized enterprises. The scale of operation has been low, and there have not been significant barriers to entry so that industry concentration levels have been below the manufacturing average (OECD, 1983b, p. 25).

The first major program of adjustment assistance was established under the *Cotton Industry Act* of 1959. The Act's aim was to reorganize and re-equip the industry to make it more competitive (Miles, 1976, p. 189). The Act included proposals to scrap equipment by offering subsidies and to install new equipment by offering grants. Employees who became redundant were to be compensated with funds obtained by means of a levy on the industry.

The target reductions of 50 percent in spinning and 40 percent in weaving were very nearly reached (Miles, 1976, p. 190), but the problem of excess capacity was not solved. The scrapped machinery included large amounts of old machinery that was largely worthless. Moreover,

the reduction in machinery was balanced to some degree by an increase in shift work (Briscoe, 1971, p. 134).

The extent of re-equipment fell short of the government's expectations. Re-equipment expenditures amounted to £53.5 million, but not the projected £80–95 million (Miles, 1976, p. 191). Concerns over rising imports and declining domestic production reduced incentives for new investment (*ibid.*). The industry's labour force declined from 241,000 workers in 1959, to 164,000 in 1964, the end of the re-equipment phase (*ibid.*, pp. 191–92).

The *Cotton Industry Act* is generally viewed as having failed to restore the cotton industry's competitive position or profitability (Miles, 1976, p. 192; Shepherd, 1983, p. 43; OECD, 1983b, p. 111). The pressure for import controls continued, and only six years later the government initiated a major new study of the industry problems.

The Textile Council's Report, published in 1969, focussed on future demand prospects, the need for an up-to-date marketing policy, and the necessity for further structural changes. The Council recommended that the British textile industry become more concentrated: four or five firms should be responsible for over half the product output, and there should be a small number of medium-sized firms and a larger number of small firms. It was suggested that outside agencies might advise on the merits of specific mergers (Miles, 1976, pp. 199–200). The Council rejected the idea of another government-financed scheme to buy out surplus capacity. It did, however, propose investment incentives: the government, in the Council's view, should establish a temporary investment-grant system for textile companies situated outside the Development Areas, and depreciation allowances on textile machinery should be increased (*ibid.*, p. 200).

In response to the Council's Report, the government appointed consultants who worked with the Industrial Reorganization Corporation (IRC) to advise on potential mergers between medium and small firms. It rejected the investment-grant proposal, but did increase depreciation allowances (Miles, 1976, p. 201).

Further government intervention also took place. In 1970, the government established a special loan fund for medium-sized and smaller textile companies to facilitate re-equipment and expansion. The scheme was administered by the IRC, and although a merger was not a necessary precondition for obtaining a loan, a major function of the IRC was to promote mergers (Miles, 1976, p. 201).

Perhaps the greatest change in the structure of the British textile industry took place as a result of the initiatives of Courtauld's, Great Britain's largest producer of cellulose fibres. From the early 1960s Courtauld's had acquired a substantial share of the British textile industry, especially the cotton industry. To become competitive with the larger volume of imports of standard cotton cloth, Courtauld's pursued a mass-market strategy involving vertical and horizontal integration. The com-

pany also succeeded in securing enhanced quota protection, in 1966, for its "reborn-infant industry." Other large textile firms, ICI in particular, followed Courtauld's strategy.

The Monopolies Commission, however, saw possible disadvantages to Courtauld's policy of expansion. As of 1969, the Commission proposed that further acquisitions which might give the company a market share of more than 25 percent in any sector of the industry be scrutinized (Knight, 1975-76, p. 15).

As a result of these acquisition initiatives, the level of concentration in the British textile industry rose sharply. The share of establishments with more than 1,000 employees in value-added increased from less than 13 percent in 1948 to 22 percent in 1980 (OECD, 1983b, p. 25). By 1976, the five largest British textile firms accounted for more than half of textile employment and an even larger share of sales (*ibid.*). This process also saw substantial modernization as marginal, antiquated firms were driven out of business.

More recent selective assistance to the textile industry has been provided under the 1972 *Industry Act*. The wool industry has been assisted in two stages under the Wool Textile Industry Schemes introduced in 1973 and 1976, with grants conditional on the scrapping of capacity (OECD, 1983b, p. 111). A study concluded that the £24 million made available had an important leverage on investment and improved the performance of the industry. Significant reductions in capacity and employment were evidence of resulting rationalization (OECD, *ibid.*).

A Clothing Industry Scheme was introduced in 1975, with the objective of encouraging reorganization and rationalization within firms. Assistance was provided to employ consultants to advise on the introduction of more productive machinery and other projects involving restructuring (OECD, 1983b, p. 112). The scheme, which closed for applications at the end of 1977, provided £20 million assistance to the clothing industry (*ibid.*).

Government intervention in the textile industry, especially since 1973, has been motivated by employment-maintenance considerations. With growing unemployment, a major concern has been that workers displaced from the textile sector would experience substantial difficulty in obtaining alternative employment. In Great Britain this is a major concern, as the textile industry is regionally concentrated in the early centres of industrialization, such as the East Midlands, Yorkshire and Humberside, where other distressed industries such as steel and shipbuilding are also overrepresented (OECD, 1983b, p. 76).

The Temporary Employment Subsidy (TES) introduced in 1975 was a general subsidy of particular benefit to the textile and clothing industries. Its purpose was to reduce redundancies and to preserve employment capacity *in situ*, in readiness for an economic recovery. Firms received payment of £20 per week for each worker faced with redun-

dancy, subject to a minimum number of likely redundancies (Chard and MacMillan, 1979, p. 153). Safeguards were introduced to ensure that the subsidy was utilized only by firms which were solvent, but suffering a temporary decline in orders sufficiently serious to jeopardize the company's survival (OECD, 1983b, p. 117). At its height, in 1977, nearly 230,000 workers had benefited from the scheme (Chard and MacMillan, 1979, p. 153). Of these, the textile, leather, clothing and footwear industries accounted for over one-half the total. These industries received a disproportionate amount of assistance, as they employed only about 4 percent of the total British work force (ibid.). The scheme closed for applications in March 1979. It had earlier been modified to restrict the benefits to the textile, clothing and footwear industries (OECD, 1983b, p. 117). In 1978, TES was replaced by short-time working subsidies (Shepherd, 1983, p. 45).

IMPACT OF INTERVENTION

The interaction between British trade and domestic adjustment policies has been uneasy. "Temporary" restrictive trade policies, designed to provide the British textile industry with adjustment "breathing spaces," have become permanent. While these policies have provided relief to firms in difficulty and protected employment, they have hindered modernization and rationalization (OECD, 1983b, pp. 126-27). Less efficient firms which otherwise would have disappeared have been protected, and more efficient firms have been encouraged to expand capacity (ibid.).

From the early 1960s, the structure of the British cotton industry did experience a transformation as the output, employment and concentration statistics indicate. There is some doubt, though, whether government adjustment assistance, particularly through the *Cotton Industry Act* of 1959, was responsible for this transformation. Caroline Miles (1976, p. 205), in her study of the British cotton industry, concludes that government policies — in particular financial assistance — did not have a significant impact.

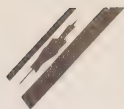
Employment policies have emphasized employment maintenance rather than reduction of costs to those displaced. These measures have kept some of the more labour-intensive — and least efficient — plants in operation (OECD, 1983b, p. 128).

The most sustained effect on the structure of the textile industry came from the horizontal and vertical integration of Courtauld's and ICI in the 1960s. Courtauld's mass-market strategy has not been successful, however. Too little attention was paid to specialization, development of products for new outlets, and marketing (OECD, 1983b, p. 136). The U.K. market was not large enough or homogeneous enough to sustain a mass-market strategy (Shepherd, 1983, p. 45).

Conclusions

The lack of political consensus on the aims and scope of industrial policy has left a deep imprint on the nature of the industrial assistance policies that have been developed by British governments. Saddled with an elusive consensus on the role of the government in relation to industry, British policy toward declining sectors has been notable for its ad hoc attempts at preserving the status quo. While large amounts of government assistance have been made available to declining sectors, premised on rationalization, such aid was, in fact, largely unconditional.

Another feature common to the declining sectors studied concerns the government's inability to withstand pressure for assistance from declining industries when industry employment is affected. Even when a government is firmly committed to a non-interventionist stance, the political power wielded by ailing firms and their organized labour forces has generally been sufficiently strong to force government to abandon such a position. The government's inability to insulate itself from political pressure is heightened when needy firms are concentrated in depressed regions. Ironically, in many cases, government regional assistance attracted firms to these areas originally (as happened with the motor-vehicle industry). The government's tendency to capitulate to industry when employment effects are involved has been increased by the nationalization of British firms. The government's intervention rendered it more responsible for the operation of the firms and thus less able to distance itself from the costs of transition. A corollary of this phenomenon has been that if government has not been firm about labour retrenchments, even massive amounts of investment aid have not been productive.



The Australian Policy Approach to Declining Industrial Sectors

The Policy-Making Process

The challenges posed by industrial decline in Australia have been accorded a position of premier importance on the political agenda. Australian efforts to reform and revitalize ailing industries are not of recent vintage. This is mainly because the deficiencies extant in Australian manufacturing, such as high levels of protection, dismal export performance, and poor productivity, have been chronic for some time. This situation in part reflects the inherent limitations of a small domestic market and high costs of penetrating distant export markets. Moreover the robust performance of the outward-looking primary sector has served to accentuate further the problems of ailing manufacturing industries.

Successive governments in Australia have devoted considerable energy to devising policies aimed at addressing the difficulties sustained by the manufacturing industry. Essentially, the benefits derived from greater efficiency depend on the rationalization and restructuring of chronically depressed industries. Despite concerted efforts, the efficacy of the various policies implemented has been limited at best. With some notable exceptions, the complexion of the problems faced by the industries undergoing the most serious decline has changed little in the past decade. These industries still attract high levels of protection in the form of tariffs, quotas, import licensing, and local-content plans in order to avert further decline. Productivity and efficiency have remained constant or fallen, and the pace and extent of structural adjustment have been slow and limited.

To understand the failure of the Australian government policies to induce significant change in the structure of the manufacturing sector, it

is necessary to examine in a political context the interaction between industry interest groups and government decision makers. Since only rarely will structural change be accomplished without dislocations of labour and capital, groups potentially harmed by restructuring will become active in the political market-place in order to prevent, or at least forestall, change. The success of these efforts made by industry groups has reflected the government's sensitivity to the needs of a relatively unskilled, immobile, labour force concentrated in certain regions of the country. By accommodating the demands of industry and labour, the rationalization of industries such as textiles, footwear and motor vehicles has been effectively retarded.

Role of Political Parties

The role that the three major political parties play in formulating industrial policy is not as important on an ongoing policy-making basis as that played by the Australian bureaucracy or interest groups (Loveday, 1982, p. 21). The reason is that the parties are in fundamental agreement about the role that government is to play in the process; another cause is the inability of the parties to overcome internal divisions and develop sharply focussed positions on industrial policy (ibid.). However, while the parties enjoy general agreement on the nature of government intervention, there is significant disagreement over "who [is] to benefit from governmental intervention, and by how much, and about how to intervene" (ibid.). Historically, the Australian Labour Party has been committed most strongly to assistance for manufacturing industry. Largely, this commitment reflects the party's formal and informal links with the trade-union movement. The Liberal Party has also been strongly in favour of assistance to manufacturing industry, "even if some members were not enthusiastic about it" (Warhurst, 1982, p. 30). Despite the fact that the Country party is supported primarily by rural voters, it favoured high tariffs for manufacturing industry throughout the 1950s and 1960s. Indeed, the Country party ensured that its advocacy was effective by insisting that its leader be appointed minister of trade.

Role of Bureaucracy

The federal division of powers in Australia has entailed a division of authority for formulating policies designed to assist ailing industry in Australia between the Commonwealth and State levels of government. Moreover, within each level of government, authority over industrial policy is dispersed among a range of departments and statutory agencies. The result is an industrial policy which is a "collection of uncoordinated and at times conflicting policies devised to meet specific problems" (Warhurst, 1982, p. 23).

Role of Business Organizations

Australia's federal structure has required that industry establish representative organizations at both the federal and state levels. The Confederation of Australian Industry (CAI) is the leading spokesman for industry at the national level. The CAI functions alongside another national association, the Australian Chambers of Commerce. At the State level, Chambers of Commerce represent industry.

As a consequence of the many different industrial interests represented in the peak business organizations, "diversity and disunion" often characterize their activities (Matthews, 1980, p. 451). In addition, competition and discord have marked the relationship between Commonwealth and State associations (Warhurst, 1982, p. 115). These features suggest that no single perspective on industrial policy is offered by industry associations. Industry associations at both the federal and state levels may have distinctly different views of the desirability of a given policy. Moreover, if the costs or benefits of a government measure are focussed on a particular industry, the industry itself may by-pass the general business organizations and make its own representations to government.

Role of Labour Organizations

Australia is a highly unionized country; 58 percent of the work force is associated with a union (Matthews, 1980, p. 430). Like industry associations, labour-representative organizations have been established at the federal and state levels. The largest peak organization is the Australian Council of Trade Unions (ACTU). The ACTU has 128 affiliates, and its membership is comprised of 70 percent of the total trade-union membership (ibid.). As with industry organizations, certain policies have caused labour unions most directly affected to break ranks with the peak association.

Role of the Banks

Relative to other nations surveyed, the commercial banking system in Australia is highly concentrated; the four largest commercial banks control 87 percent of all commercial bank assets ("Competition," 1980, p. 101). Because of recent deregulation of banking, however, concentration may be expected to decrease (Field, 1984). In September 1984, for example, in order to increase the level of efficiency and innovation in the banking industry, the government invited both foreign and domestic interests to apply for permission to establish new banks.¹ Although it was anticipated that a minimum 50 percent of equity in these new banks would be derived from domestic sources, the government signalled that

it would be prepared to consider proposals involving less than 50 per cent Australian equity in areas where it had been determined that "significant benefits" would accrue to Australia.² Unlike banks in Japan, Germany and France, Australian banks do not work closely on an ongoing basis both with firms and with the state in the credit-allocation function.

General Programs

The Industrial Assistance Commission

Among the myriad agencies and departments charged with responsibility for formulating and administering industrial policy in Australia, the Industrial Assistance Commission (IAC) is of major importance. The IAC owes its importance to the marked propensity of Australian governments to extend assistance to industry in the form of tariff support; indeed, the tariff has represented the major form of assistance to industry in Australia (OECD, 1973, para. 234). Currently, the tariff retains this function; in 1974, out of the \$2.5 billion expended in aid to industry, \$2.25 billion derived from tariff protection.³ The tariff is preferred over other industrial policy tools because of its capacity to convey substantial benefits to industry without the imposition of focussed costs. In a recent study, Anderson (1980) examined the rates of effective assistance to Australian manufacturing industries in the period 1968/69 to 1977/78 to identify the factors that had influenced the extent of assistance. He found that "labour intensive, low wage industries with low value-added shares of output are the most highly assisted. Secondly, industries with fewer firms and perhaps having larger numbers of employees tend to be assisted more." This observation is consistent with the result predicted by the political model set out in Chapter 1.

The IAC is the successor agency of the Tariff Board (TB), which was established in 1921. The TB, an independent statutory agency responsible for advising government on tariff policy for Australia, was set up in order to insulate the government from political pressures involved in setting tariff levels. The TB's mandate was confined to advising the government on the efficacy of tariff protection for secondary industries. When, in 1972, the Board was reconstituted as the IAC, the agency was empowered to advise government on a broad range of assistance measures relating both to primary and to secondary industry. Essentially, the *IAC Act* stipulates that in a number of circumstances, the government is required to refer to the IAC matters relating to industrial policy. The IAC will then undertake an investigation of the matter, which may include hearings, and subsequently report to the government. Pending the outcome of this process, the Temporary Assistance Authority, under the *IAC Act*, may permit temporary protection to be extended to industries in

need. The IAC's powers are limited by its dependence on the government to initiate the reference process. In addition, the IAC enjoys only an advisory role and, consequently, the government is not obliged to accept its advice.

The most notable contribution of the IAC to industrial policy has been its review of industries receiving protection, undertaken to ascertain the appropriate level of assistance. These industry reviews were introduced in 1967, by the former head of the TB, and the IAC has continued this process. The program was instituted as a response to the extension of protection on a "needs" or "cost-disability compensation basis" which had resulted in an assistance structure with widely disparate levels of assistance for different activities, industries and sectors of the economy (McKinnon, 1982, p. 136). The IAC, by evaluating the needs of all industries against the same criteria, sought to rationalize the uncoordinated and ad hoc structure of protection in Australia. By 1978, the IAC or its predecessor, the TB, had reviewed industries constituting 20 percent of total manufacturing value-added (Australia, 1981, p. 19).

The benchmark against which the IAC evaluated tariff policy was efficiency. Social and political concerns were either relegated to a position of secondary importance or not considered at all. This practice was attributable both to the language contained in the *IAC Act* and to the overwhelming preponderance of economists employed by the IAC. As a result of its efficiency stance the IAC recommended reduced assistance for most industries examined in its review process. This brought the agency into direct conflict with government departments such as Business and Consumer Affairs (BACA), and Industry and Commerce.

In contrast to the more technical approach of the IAC, the stance of these departments was more sensitive to the political consequences of the IAC's recommendations. On a number of occasions, cabinet and Parliament were persuaded by BACA and the Department of Industry and Commerce to reject recommendations which contained the greatest potential for antagonizing powerful industrial lobbies or jeopardizing employment (Bulbeck, 1983, p. 234). Thus, while the IAC succeeded in inducing reductions in the average rate of protection across all manufacturing industries from 36 percent in 1968/69 to 26 percent in 1977/78, the most chronically depressed industries were able to secure an increased level of assistance in the same period (*ibid.*, p. 232).

Other Government Bodies Involved in Policy for Declining Sectors

The principal Commonwealth departments charged with administering policy in favour of declining industry are: BACA; Department of Finance; Industry and Commerce; and Urban and Regional Development. Briefly, BACA is responsible for relations between the government

and the IAC, as well as for administering and interpreting tariff legislation. This authority has enabled BACA to play a significant role in the formulation of industrial policy. The Department is considered "neutral" in the sense that it is perceived to be equally receptive to consumer and business interests. The assistance-policy role of the Department of Finance is based on the department's responsibility for evaluating assistance schemes which involve government expenditures. Unlike BACA, the Department of Industry and Commerce is a client department which is tied closely to manufacturing interests. It administers a number of non-tariff assistance measures, such as quotas and local content plans. The responsibilities vested with the Department allow it to serve as the primary communication conduit between government and business. Finally, Urban and Regional Development's role is to bring regional concerns into the industrial policy-making process of the Commonwealth government.

The Structural Adjustment Act

In June 1973, the Australian Labour Party (ALP) set up a six-member committee to investigate ways of reducing record inflation levels. The recommendations of this committee, contained in a report entitled "The Report on Possible Ways of Increasing Imports," combined with a prevailing spirit of tariff reform, led the ALP government, in July 1973, to institute a 25 percent reduction in tariff levels across the board (Warhurst, 1982, p. 34). Soon afterward, the output and employment of domestic manufacturers nosedived, while foreign imports increased dramatically. Within a two-year period, 40,000 manufacturing employees became unemployed (Australia, 1981, p. 87). This figure represented close to 10 percent of manufacturing employment. Whether or not the tariff reduction was solely, or even mainly, responsible for the surge in imports and consequent unemployment is a matter of continued debate. It has been asserted that only 7 percent of the increase in imports was connected to the tariff reduction (ibid.).

Regardless of the accuracy of the perception, the notion that the government's 25 percent tariff reduction was responsible for the decline in employment received wide credence. In these circumstances, the government was forced to attempt to ameliorate the difficulties sustained by dislocated labour and capital. In 1974, it unveiled the *Structural Adjustment Act* (SAA). The object of the Act was to enhance resource mobility in order to facilitate the flow of capital and labour out of declining sectors and into more competitive sectors. Basically, the program consisted of five different forms of assistance. Eligibility for receiving aid under any of the five heads was established when workers or firms demonstrated "a direct relationship between their layoff or decline in sales and specific government decisions" (United States, 1979, p. 16).

Authority for determining which government decisions would be included within the ambit of the program was vested with the cabinet. Because of the public perception that reductions in protection were primarily responsible for structural decline, the cabinet chose to compensate almost exclusively those workers or firms in industries subject to lowered tariff and quota levels.

INCOME MAINTENANCE

In terms of the total amount of funds dispersed, the major form of assistance under the Act was the provision of temporary income maintenance to unemployed workers. Unlike general unemployment schemes, which provided a standard level of benefits irrespective of prior income, the SAA granted six months of benefits at the employee's previous average wage. This extension of income maintenance to displaced workers, based on criteria related to equity and efficiency, was subject to particularly intense criticism. First, critics asserted that the program created a privileged class of the unemployed. Only those workers who were employed in industries experiencing structural change relating to changes in tariff policy were to receive the higher level of benefits; workers employed in industries undergoing structural change that cabinet determined did not result from specific government decisions would be ineligible. Moreover, those industries affected indirectly by the "specific government decisions" (that is, suppliers of labour and products for the industries within the purview of the legislation) would not receive the benefits. Thus benefits would accrue to those unemployed workers falling within the narrow eligibility requirements of the SAA — about 5 percent of all unemployed persons — while the remainder of the unemployed work force received the lower level of unemployment benefits. Secondly, the extension of temporary income maintenance provided little incentive for unemployed workers actively to seek alternative employment opportunities; even previous overtime earnings were accounted for in the scheme. In all, \$59.3 million was allocated under the scheme over the two-year period that it was in operation (United States, 1979, p. 18).

RELOCATION ASSISTANCE

Relocation assistance was designed to encourage unemployed workers to accept employment in growing industries located in distant regions. Assistance under this head was extended in terms of grants tied to moving costs. The program was unsuccessful, partly because of the nominal levels of assistance offered as an inducement, and partly because of the strong ties binding workers to their home regions. In all,

only three workers received relocation assistance under the scheme (United States, 1979, p. 19).

CLOSURE COMPENSATION

Closure compensation offered compensation to firms closed because of "specified government decisions." Compensation was provided for major capital depreciation; it was based on 85 percent of the value of the difference between the book value and residual value of the assets. Between April 1974 and May 1977, the government paid \$1.3 million to compensate for the closure of 51 firms (United States, 1979, p. 19). Difficulty in meeting the eligibility criteria prevented more firms from taking advantage of the scheme.

CONSULTANCY GRANTS AND LOAN GUARANTEES

Although provision was made for restructuring assistance in the form of consultancy grants and loan guarantees, neither form of assistance was ever granted. Again, overly stringent eligibility criteria and low levels of assistance accounted for the lack of program utilization.

Special Assistance to Non-Metropolitan Areas

Shortly after the introduction of SAA, the ALP government unveiled additional structural adjustment measures which were tailored directly to the requirements of labour and capital in rural regions. The program was predicated on the notion that "firms and employees in areas where alternative income-producing activities were few or non-existent may need additional measures for the facilitation of change" (Australia, 1979b, Appendix 6.2, p. 6.2.5).

Special Assistance to Non-Metropolitan Areas (SANMA) made direct-subsidy assistance available to help firms both to phase in alternative production capability and to phase out unproductive plant and equipment. In special circumstances, the use of subsidies to support existing production was permitted.

Rather than facilitating structural adjustment, however, the program acted to impair the movement of resources out of inefficient industries. The receipt of SANMA subsidies worked only to encourage the vast majority of firms to maintain existing levels of employment and output. In fact, it has been argued that the effect of the program was "entirely negative in emphasis and did little . . . positive to solve problems" (Australia, 1979b, Appendix 6.2, p. 6.2.18).

The primary beneficiaries of SANMA were workers employed in firms receiving assistance under that program. Although SANMA was "not directed specifically towards Victorian industry or the textile, clothing

and footwear industries, the scheme was of considerable benefit to both" (Warhurst, 1982, p. 50). Indeed, out of the \$5.1 million paid to 40 firms, only four grants totalling \$.392 million were made outside the textiles, clothing and footwear sector (ibid.). This is not surprising in view of the pivotal role that representatives of these industries played in securing the creation of SANMA.

The deficiencies afflicting both the SAA and SANMA were so severe that by the end of 1976 the programs were allowed to expire.

General Unemployment Assistance

The criticism levelled at the SAA and SANMA programs led the government to make retraining and relocation assistance available to *all* unemployed workers. The retraining assistance scheme was introduced in October 1974; it offered retraining assistance to both unemployed workers and employed workers seeking to upgrade their skills. The program was not successful because it was inundated with applications from unemployed workers interested only in realizing the higher level of benefits it offered relative to general unemployment insurance. To discourage oversubscription, the program was modified, in 1976, to emphasize on-the-job training. Currently the government offers a number of retraining schemes. Some of the most important are Commonwealth Rebate for Apprentice Full-Time Training (CRAFT), which compensates employers for the cost of releasing apprentices to attend off-the-job training courses; Skills in Demand, which promotes the training of persons in skills which are in particular demand by industry; and General Training Assistance, which provides subsidies to employers who will employ and train an unemployed person if they are unable to obtain a suitably trained applicant.

To assist in labour mobility, the Commonwealth government also has instituted a Relocation Assistance Scheme (RAS) and Fares Assistance Scheme (FAS). RAS "assists the relocation of unemployed people or people who have received notification of impending redundancy and who are unable to obtain within a reasonable time continuing employment in the area in which they live" (Australia, 1983c, p. 206). FAS assists unemployed people to attend job interviews with prospective employers.

Sectoral Programs

The Motor-Vehicle Industry

BACKGROUND

In 1980, 7 percent of all employees in the manufacturing sector were directly employed in the motor-vehicle industry; in the same year that

industry accounted for 7.3 percent of total manufacturing industry output (United Nations, 1982, p. 16). In view of the size of the motor-vehicle industry, the Commonwealth government has been reluctant to allow market forces to play a predominant role in shaping the structure of the industry. Indeed, throughout the 50-year history of the motor-vehicle industry, government intervention has been the crucial variable determining the nature of the industry. In these circumstances, current government policy toward the industry is designed to address challenges that are largely the product of policies adopted by earlier governments. For instance, government intervention has encouraged the concentration of a high proportion of motor-vehicle manufacturing in Adelaide, South Australia (Warhurst, 1982, p. 182). The industry is characterized by a high degree of fragmentation and low levels of scale. The IAC found, for example, that at 1973 production levels, the country could support production of motor vehicles at only five plants operating at minimum efficient scale; however, 12 plants were operating at that time (Williams, 1982, p. 8, Table 1.2). Moreover the industry is "dominated by a small number of largely foreign-owned firms with large employment, some in politically awkward locations" (Warhurst, 1982, p. 183). To ensure its continued viability, the Commonwealth government has had to offer generous levels of assistance to the industry.

GOVERNMENT INTERVENTION

Assistance to the motor-vehicle industry in Australia has been coloured by ongoing tension in the Commonwealth government between the desire to promote greater efficiency and growth in the industry and the desire to ensure that the motor vehicles which are sold in Australia are built mainly of domestically manufactured components. For example, soon after the removal of import licences in the 1960s, the volume of components imported into the country increased dramatically. This greater use of imported components led the Commonwealth government to introduce a local-content plan designed to increase the percentage of domestically produced components. The plan was based on a two-tier approach in which high-volume motor-vehicle manufacturers were required to have 95 percent of vehicle components produced domestically; less stringent levels were specified for low-volume manufacturers. The plan had the effect of grossly distorting motor-vehicle production in Australia by skewing manufacture toward low-volume runs, since a greater percentage of components for the lower-volume runs could be sourced from abroad at lower cost. Not surprisingly, the realization of economies of scale was precluded by the focus of production on low-volume runs.

The cost disability engendered by inefficient production techniques was reflected in the high degree of market penetration achieved by

Japanese imports. The share of the market held by domestic manufacturers slipped from 84 percent in 1966, to 68 percent in 1973 (Warhurst, 1982, p. 184).

To rectify this situation, the ALP government sent a reference to the IAC in December 1972. The IAC reported after holding an extensive set of hearings (Warhurst, 1982, p. 190). Given the predilections of the IAC, it was not particularly surprising that the agency recommended abandonment of the local-content plans and protection by means of a simple 25 percent tariff. The proposed changes were to be phased in over a seven-year period (*ibid.*, p. 192).

The report, although enjoying some support in the press, evoked vigorous dissent among manufacturers, unions and the South Australian government. A "full scale confrontation" ensued, which involved work stoppages, on-site meetings and a national labour conference. Essentially, the debate between the various interest groups and government officials focussed on employment. Whereas the IAC projected a net loss of 2,000 jobs over 10 years, industry contended that from 10,500 to 50,000 jobs would be lost in that period (Warhurst, 1982, p. 200).

The inability of the IAC to refute the employment estimates presented by industry significantly undermined the acceptability of the report. In fact, the government's ultimate rejection of the report and the introduction of a motor-vehicle policy which offered the industry greater protection reflected the government's sensitivity to the employment effects of reduced protection. The rejection of the IAC's recommendations derived from the predominance in the policy-making process of interests associated with manufacturing. Those groups opposing protection, such as importers, commercial users, farmers and private consumers, played only a minor role in the process.

The objectives of the government's motor vehicle policy were twofold: to accelerate the rationalization of domestic industry, and to ensure the continued production of motor vehicles built mainly of locally manufactured components. These objectives were to be realized by retaining the local-content requirements and offering the industry significant levels of protection.

The government modified the existing local-content plan by stipulating that all domestic manufacturers would be subject to an 85 percent local-content requirement. This requirement would replace the myriad provisions that had previously applied to different volumes of production. Moreover, the 85 percent level was to be calculated on the basis of a company's entire domestic production run. By including this provision, the government hoped to offer firms increased latitude in making their sourcing decisions. This greater freedom would aid in rationalizing production.

In addition to imposing the local-content plan, the Commonwealth government provided for the implementation of a range of tariffs and

quotas. These measures were to lend support to the local-content plan by controlling the total of imports competing with domestically produced motor vehicles. The tariff remains the keystone of motor-vehicle protection policy. The tariff, originally set at 45 percent in 1974, has since been revised upward to 57.5 percent (Australia, 1979b, Appendix 6.2, p. 6.2.5). The revisions in the tariff rate were induced by changes in the share of the domestic market held by imports. Although no such move was formally required by the legislation, the government has revised the tariff rate on assembled passenger vehicles in order to limit foreign manufacturers to 20 percent of the domestic market (*ibid.*).

To buttress the effectiveness of the tariff, the government made provision for the imposition of quantitative restrictions. The quota, initially conceived as a short-term measure, has "in practice had a somewhat more lasting character" (Australia, 1979b, p. 11.2.7). Indeed, securing an 80 percent share of the motor-vehicle market for the domestic manufacturers has required that the quota be applied on a long-term basis.

Motivated both by dissatisfaction with the efficiency of the market-sharing arrangement and by a commitment to enhance structural adjustment, the Labour government recently announced changes in motor-vehicle policy. The post-1984 arrangements for the industry are contained in a plan developed by Senator Button. The Button plan consists of two principal elements. First, the formal market-sharing arrangement for assembled vehicles is to be replaced by a system which allows non-quota holders to import vehicles provided that they pay an import duty. The import duty for non-quota holders stands at 100 percent in 1985, but the proportion of the duty will be reduced over seven years until it reaches 57.5 percent (Sampson and Woodbridge, 1984, pp. 48–60). At this point, the quota will become obsolete, as the level of protection offered quota and non-quota holders will be equivalent. In essence, the abandonment of import restrictions on non-quota holders signals a resurgence in the use of the tariff as the principal form of assistance to domestic manufacturers.

The second component of the Button Plan is an increase in credits available under the Export Facilitation Scheme. This scheme "allows vehicle manufacturers who export to reduce the required local content in their vehicles by replacing this content with duty-free imported components (on a dollar for dollar basis) to the value of their eligible exports." The extent of credits available under the Export Facilitation Scheme is 10 percent of vehicle content in 1985, increasing to 15 percent by 1987.

PERFORMANCE

The motor-vehicle policy enunciated by the Commonwealth government has been criticized because of its trichotomous character. The admixture of local-content plans, tariffs and quotas has done little to

promote the rationalization of industry. Cosmetic changes to the local-content plan have had limited effect on the level of flexibility that firms enjoy in their production decisions. Moreover, the imposition of protective measures has only insulated the industry from market pressures and imbued it with a sense of complacency. The capacity of the post-1984 arrangements to effect broad structural adjustment in the industry is problematic. As Sampson and Woodbridge have observed:

If economies are to be achieved in assembly and component production, and the degree of fragmentation in the component sector is to be reduced through a restructuring of production and a cutting down on the number of producers and models, then the presumption that the domestic demand which previously went to the now obsolete models will be transferred to the remaining domestically manufactured models must hold. However, what may eventuate is that this demand will be redirected to models with similar characteristics that can be purchased overseas. (Sampson and Woodbridge, 1984, p. 57)

The Footwear Industry

BACKGROUND

Like other ailing industries in Australia, footwear manufacturing is plagued by a number of difficulties which impair its efficiency. The industry is highly fragmented, and its production is on a small scale. Whereas 303 establishments constituted the entire Australian industry in 1975, in the same year fewer than 200 Canadian establishments produced a larger volume of output (Australia, 1983a, p. 14). Furthermore, the industry is extremely labour intensive; funds employed per employee in footwear manufacturing equalled \$3,590 as against \$12,550 in manufacturing generally. Out of 39 Australian industries surveyed by the Bureau of Industry Economics, footwear was found to be the second most labour intensive (*ibid.*, p. 18).

The high degree of labour intensity coupled with dramatic increases in wage rates has had a profound effect on the footwear industry's international competitiveness. In the decade between 1970 and 1980, labour costs in the industry rose by 316 percent for men and 435 percent for women (Australia, 1983a, Table 3.3.2). In total, 62 percent of the increase in production costs between 1971/72 and 1975/76 were related to the increase in female-wage rates resulting from the promulgation of equal-pay legislation (*ibid.*, p. 26). A comparative survey of footwear-wage rates across a number of developed countries showed that Australian wages were the highest (*ibid.*, Table 4.5.7).

These difficulties have eroded the share of the domestic market held by Australian footwear manufacturers; domestic manufacturers' share of the market declined from 72 percent in 1971/72 to 52.2 percent in

1974/75 (Australia, 1983a, Table 4.5.1). The industry's lack of competitiveness has necessitated the erection of formidable import barriers to avert further market erosion. In 1973/74, nominal tariff assistance to the industry stood at 30 to 40 percent (*ibid.*, p. 18).

Enthusiasm of industry interest groups and government officials for structural change within the footwear industry is tempered by the implications of rationalization for the labour force. Any changes which would increase efficiency in the industry are likely to entail major dislocations of labour. Nevertheless, in view of the composition and location of the labour force, severe retrenchments in the industry are an unattractive prospect. The labour force consists mainly of workers who possess low levels of skill or education. Half of the labour force is made up of immigrants, and 60 percent is female; of the female employees, 40 percent are married (Australia, 1983a, pp. 12–13). These figures suggest that the ability of footwear-industry employees to secure alternative employment within a short time frame is slight. Given, also, the concentration of the industry in major urban centres, any government is likely to be sensitive to political repercussions and to proceed cautiously in promoting structural change.

GOVERNMENT INTERVENTION

The response of the Commonwealth government to the structural problems inherent in the footwear industry has been conservative. Protection has been extended on an *ad hoc* basis, and no timetable has been developed for its reduction. No positive measures to ease rationalization have been initiated. For the most part, the government's policies have been guided by a desire to protect the industry from market pressures and to maintain constant employment levels. When import levels spiralled after the 25 percent tariff cut in 1973, quotas were implemented. The government extended these policies in 1975. By the end of 1977, most imported footwear was subject to a general tariff of 34 percent and to import licensing (Australia, 1983a, p. 18). In 1978/79, the IAC reported that the nominal average rate of assistance had increased from 30 percent in 1973/74 to 57 percent (*ibid.*). This increase occurred at the same time that the level of protection offered to other industries in the manufacturing sector was declining.

IMPACT OF INTERVENTION

The increase in assistance to the footwear industry that occurred during the mid to late 1970s naturally reduced pressure for changes in the footwear-industry structure. Since there was no positive adjustment edge to the protection policies, if any changes have occurred in the industry, they have taken place in spite of, not because of, government

intervention. Pressures to rationalize still exist to the extent that the increases in protection levels are insufficient to balance the growing pressures exerted by market forces.

The validity of this proposition is demonstrated by performance statistics over the last decade. The industry, as gauged by total number of establishments, has contracted by 30 percent (Australia, 1983a, p. 36). Total industry employment, which amounted to 22,151 persons in 1970, fell to 13,456 persons in 1980. The degree of concentration enjoyed by the four largest firms increased from 43 percent in 1973/74 to 52.1 percent in 1978/79 (*ibid.*, pp. 36–37).

The contraction and concomitant increase in concentration that the industry experienced during the 1970s has failed to improve industry performance. By March 1981, the share of the market held by domestic manufacturers fell by 3 percent from its 1979/80 level (Australia, 1983a, Table 4.5.1). Gross investment in the industry, necessary to reduce labour intensity by introducing labour-saving techniques, amounted to 5.8 percent of net fixed assets throughout the period 1971/72 to 1979/80; the rate for general manufacturing was 8.6 percent (*ibid.*, Table 4.3). Profitability was well below the average for general manufacturing during the 1970s, although some improvement was detected in the latter part of the decade. Similarly, productivity growth was negligible from 1969 to 1976, but increased by 8.2 percent between 1975/76 and 1980 (*ibid.*, p. 46).

The Textile and Clothing Industries

BACKGROUND

The textile and clothing industries constitute important elements of Australia's manufacturing base. In 1977, these industries contributed almost 7 percent to total manufacturing production and almost 9 percent to total manufacturing employment (OECD, 1983b, p. 15). In 1977/78, these industries involved over 3,200 establishments employing almost 107,000 persons (Australia, 1980, p. 18). Indirectly, the textile and clothing industries are responsible for employing another 180,000 persons (*ibid.*, p. 20). Total turnover for 1977/78 exceeded \$3 billion, about 6.5 percent of total manufacturing turnover, with value-added approaching \$1.4 billion, about 6.9 percent of total manufacturing value-added (*ibid.*, p. 18).

The textile and clothing industries have distinctive features which have been influential in government policy making. First, these industries provide jobs for certain distinct sectors of the labour market. For example, over 24 percent of all women employed in Australia's manufacturing sector are employed in textiles and clothing (Australia, 1980, p. 17). Secondly, textile and clothing production is regionally concentrated. Almost 90 percent of production is located in Victoria and New

South Wales. Industry is especially concentrated in the regions of Melbourne and Sydney; about 65 percent of total employment in textiles and clothing is located in these cities (*ibid.*). Textile and clothing activities in smaller centres is also extremely important, as the likelihood of local re-employment for persons displaced from these industries is limited (*ibid.*, pp. 17–18).

GOVERNMENT INTERVENTION

After World War II, Australia's textile and clothing industries were protected by import-licensing controls. These were removed in 1960, and for the next 10 years the tariff became the principal form of protection. High tariff levels, together with a stable wage structure, enabled the textile and clothing industries to avoid major market erosions until 1974. Nevertheless, there was a consistent increase in the value of imports.

Early in the 1970s Australia's competitive position in textiles and clothing changed. There was increasing competition from low-wage countries in Asia, the Australian dollar was revalued, tariffs were cut by 25 percent in mid-1973, and major wage increases occurred, particularly for female employees (Australia, 1980, p. 2).

In 1973/74, imports of textiles increased by 43 percent in constant price terms, and imports of clothing escalated by 69 percent over the previous year's level (Australia, 1980, p. 2). In 1973, there was a net trade deficit of \$–0.58 billion in textiles and \$–0.09 billion in clothing. By early 1974, the effect on employment was apparent: between March 1974 and March 1975, employment fell 25 percent in textiles and 22 percent in clothing (*ibid.*).

In 1974, the Australian government introduced the Structural Government Assistance scheme to provide adjustment assistance to those industries affected by measures such as the 25 percent tariff reduction. The scheme was shortly extended to provide Special Assistance to Non-Metropolitan Areas (SANMA). Between 1974 and 1977/78, \$1.2 million was granted as closure compensation to firms. Fifty percent of this amount went to the textile and clothing industries, and \$5.1 million was expended in SANMA employment maintenance subsidies; 85 percent of this latter sum was directed to textile and clothing industries (Australia, 1980, p. 3). A further \$59.4 million was spent on income-maintenance benefits for 25,520 displaced workers, 65 percent of whom had been employed in the textile and clothing industries (*ibid.*).

Until 1975, Australia dealt with imports in conformity with the Multi-fibre Arrangement (MFA). After 1975, it replaced the restraints it had applied against a small number of exporting countries with a system of tariff quotas (OECD, 1983b, p. 170). For two reasons these tariff quotas were not effective in insulating the domestic industry from imports. First, the tariff quotas were set at too high a level; secondly, they omitted

a significant range of products (Australia, 1980, p. 4). The government asked the Textile and Apparel Industry Advisory Council to review the quota levels; in 1977, it announced that quotas would continue as the central element in a three-year sectoral program which was subsequently extended by one year. A Textile, Clothing and Footwear Review Committee was established to advise regularly on quota levels. The central theme of this program was the maintenance of output and employment levels to mid-1981; during this period the local industries were expected to try to improve their efficiency.

In August 1980, the Australian government announced a new Program of Assistance for the Textile, Clothing, and Footwear Industries; the program would last for seven years from January 1, 1982. It is intended to provide a climate in which these industries will be subject to gradual and manageable change.

Under the program most yarns are quota-free and subject only to minimum duties. Assistance to most of the industry is provided by bounties. Most fabrics are subject to duties, but not to quotas. Tariff quotas remain on a range of woven synthetic fabrics and some finished textile products. The initially established quota levels were based on those in force in 1979/80; quotas increase annually at about 2 percent (OECD, 1983b, p. 170). Market growth is opened up to competition. The number of quota categories is reduced to 20 clothing and six textile-product categories to provide greater flexibility (*ibid.*).

IMPACT OF INTERVENTION

The sectoral policy introduced in 1977 resulted in a more stable operating environment for the textile and clothing industries. From 1977 to 1979, employment remained within 1 percent of a level of 107,500 persons (Australia, 1980, p. 5). This level is, however, much lower than that of 146,800, which obtained in 1974. The number of establishments dropped by 11 percent from 3,682 in 1972/73 to 3,264 in 1977/78, though at a diminishing rate. Over the four years to 1976/77, the textile industry showed the greatest rate of increase in gross product per person employed within manufacturing, and the clothing and footwear industries' rates were above the manufacturing average (*ibid.*, p. 6). After a decline in the competitive position of Australian textile and clothing manufacturers to 1976/77, a reversal in this trend appeared in 1978/79; this reversal was reflected in the ratio of import prices to the prices of articles domestically produced. Profitability in the textile and clothing industries improved in 1977/78, largely reflecting increases in productivity and technical efficiency (*ibid.*, pp. 8-9).

There is some doubt, however, whether the continuation of tariff quotas will encourage the Australian textile and clothing industries to rationalize. The government is intent on protecting existing employment

rather than on aiding workers displaced by the process of rationalization. Employment considerations currently loom large in government policy making. The industries are labour intensive, employing a high proportion of female and migrant employees who have limited prospects of finding other jobs. Moreover, the textile industry is geographically distributed so that many regional centres, especially within Victoria, depend for their prosperity on textile and clothing firms.

Given the long-term pressures on the textile and clothing industries, especially severe competition from imports, and the limited size of the Australian market which limits economies of scale, protection will probably not prevent the continuing decline of these sectors (Watson, 1981, p. 29).

The Whitegoods Industry

BACKGROUND

In the industries examined so far, the efficacy of government attempts to promote the rationalization and restructuring of ailing industries has been highly problematic. For the most part, Commonwealth policies in these industries tended to forestall or, indeed, preclude structural adjustment. The whitegoods industry provides a lone exception to the government's record of failure. Here, in fact, the Commonwealth government can be credited with playing a pivotal role in directing structural adjustment.

Traditionally, the whitegoods industry in Australia has enjoyed high levels of protection. Before the 25 percent tariff cut was effected in 1973, general tariff rates for Australia whitegoods ranged from 37.5 percent for refrigerators and freezers, to 55 percent for washing machines (Australia, 1983b, Table 2.4.1). In addition to protection afforded by the imposition of tariffs on imports, Australian whitegoods enjoyed significant levels of natural protection because of their substantial volume and weight compared with value. This value ranged from 30 percent on the f.o.b. value of dishwashers, to 60 percent on refrigerators (*ibid.*, p. 17).

Despite high levels of protection, Australian whitegoods still suffer massive price disabilities against imports. In 1978, for instance, domestic washing machines were priced 70 percent to 90 percent higher than were Japanese imports, and domestic refrigerators (200–450 litres) were priced 155 percent higher than Yugoslavian imports (Australia, 1983b, Table 4.4.7). The dismal competitive position of Australian whitegoods is primarily attributable to the high costs of manufacture generated by fragmented production. The number of firms competing in the industry precludes the realization of minimum efficient scale by any one firm: average plant-utilization rates for Australian manufacturers of air conditioners and refrigerators are only 38 percent and 68 percent respectively (Australia, 1979b, Appendix 6.2, p. 11.2.28). Moreover, while high levels of concentration in the manufacture of Australian whitegoods temper

the effects of fragmented production, they do not erase it entirely. As a result, the industry is characterized by short production runs and a surfeit of models and products in a relatively small domestic market. In addition, high and rising costs of material and labour inputs exacerbate the price disability sustained by whitegoods manufacturers; between 1968/69 and 1980/81, component costs increased by over 225 percent (Australia, 1983b, Table 3.3.1).

GOVERNMENT INTERVENTION

Following the 25 percent tariff cut effected in 1973, the share of the domestic market held by Australian manufacturers of whitegoods fell considerably, by 27 percent and 12 percent in the refrigerator and washing-machine segments respectively (Australia, 1983b, Table 4.4.1). The loss in market share was accompanied by a period of substantial employment displacement. In the period between June 1974 and June 1975, jobs in the whitegoods industry decreased by close to 25 percent; this figure can be compared to the 10 percent fall in employment in manufacturing generally (*ibid.*, p. 60). The job losses were concentrated in New South Wales, South Australia and Victoria, where employment fell, respectively, by 37 percent, 13 percent and 10 percent (*ibid.*).

The severe labour displacement and the lobbying by representatives of industry, labour and state governments caused the Commonwealth government to reintroduce protective measures. These measures involved extending emergency assistance by means of import quotas to manufacturers of refrigerators, washing machines and clothes dryers. The protection lasted until July 1978.

In 1978, the government unveiled its long-term policy to deal with the whitegoods industry. The plan was conceived after receipt of an IAC report which called for the rapid reduction of protection for the industry. This report was premised on the belief that restructuring would increase employment in the industry. After heated debate which focussed mainly on the rate at which reductions in tariff levels would be implemented, the government adopted a modified version of the IAC proposal.

Essentially, the government decided to abandon the protection afforded the whitegoods industry by quotas and to replace the quotas with temporarily high tariffs. To promote the rationalization of industry and to set up an environment conducive to the realization of minimum efficient scale by firms, the government designed a timetable which would reduce tariff levels progressively from 47.5 percent to 30 percent (Australia, 1983b, pp. 14–18).

Although the IAC report on the whitegoods industry recommended a phase-in period of four years, the government, as a concession to industry, allowed a six-year period. This decision followed an intense period of lobbying by industry, which argued that the four-year period would not allow sufficient time to rationalize.

IMPACT OF INTERVENTION

The impact of the 1978 whitegoods policy on the pace and direction of structural change in the industry was significant. Trends evident in the industry prior to the development of the 1978 policy were reinforced. Rationalization via "mergers between firms, the development of cross-supply arrangements, and the closure of marginal enterprises . . . [continued throughout] the 1970s" (Australia, 1983b, p. 37). It has been observed, for instance, that "since the announcement of the government's [1978] policy measures . . . merger activity has increased. In 1979, Email took over Kelvinator, Simpson took over Malleys, and Rank Industries Australia merged with Australian General Electric Appliances" (*ibid.*, p. 38).

Coincident with the heightened merger activity in the industry was the development of cross-supply arrangements between competing firms. Under these arrangements firms producing competing products agree that one firm will manufacture all of the goods normally produced by itself and the other participating firms. The "non-producing" firms will then purchase the "producing" firms' output and distribute it under its own label. Such cross-supply arrangements reduce costs through realization of economies of scale. The use of cross-supply arrangements has been somewhat inhibited, however, by doubts about the effect on these arrangements of Trade Practices (antitrust) legislation (Australia, 1983b, p. 39).

The increase in mergers and the concomitant withdrawal of marginal firms from the industry has had a profound impact on the number of firms in the entire industry. In 1950, there were 40 firms in the whitegoods industry; there were 20 such firms in 1970; by 1978, the total number of such firms stood at 15 (Australia, 1983b, p. 18). The reduced number of firms in the industry has allowed notable rationalization to occur in particular product segments. In 1978, for example, the IAC found six firms manufacturing washing machines in Australia; it suggested that efficiency dictated that there be only four such firms. By 1981, only two major manufacturers of washing machines remained (*ibid.*, p. 39). Similarly, in 1978, the IAC found five plants producing clothes dryers, and it recommended that the industry should consist of only two; by 1981, three firms remained, and one possessed heavy market dominance in both domestic production and importing (*ibid.*).

The growing levels of concentration prevailing in the industry are further evidence of rationalization: in 1971, the largest two and four firms accounted for 31 percent and 52 percent of domestic production (Australia, 1983b, pp. 38, 40). By 1981, the share of production held by these firms had climbed to 69 percent and 87 percent respectively (*ibid.*).

The benefits accruing from rationalization of the whitegoods industry have been translated into gains in productivity: "Average growth was 6.4% a year between 1969/70 and 1974/75 and this increased to 10.2%

between 1974/75 and 1979/80. Since 1977/78, the rate has been 14% a year" (Australia, 1983b, p. 40). Profitability, however, while increasing from 1976/77 to 1979/80, has still been consistently below the average for all manufacturing industry (*ibid.*, p. 45).

A number of factors account for the success of the Commonwealth government in promoting the rationalization of the whitegoods industry. Most important was the government's resolve to reduce the long-term levels of protection for whitegoods. In addition, the relatively lower contribution of labour to the manufacture of whitegoods (as compared to textiles and footwear) suggests that the leverage enjoyed by labour in securing assistance might not have been as great as in other industries, although both the 33 percent decrease in industry employment that took place in a few states, between 1974 and 1979, and the lack of mobility available to industry workers might qualify such a supposition (Love-day, 1982, p. 182).

Conclusions

A number of features explain the relative lack of success that the Australian government has experienced in responding positively to adjustment pressures in declining industries. The government's heavy reliance on trade measures has hindered its ability to fashion bold and innovative solutions for declining industries. Attracted by the tariff's capacity to impose subtle costs on importers, producer groups and consumers, Australian decision makers have had little enthusiasm for introducing direct assistance schemes, which involve the imposition of more overt costs.

Government intervention through trade policy has not served to encourage rationalization and restructuring of industry. The lone exception to this observation is provided by the whitegoods industry, where rationalization was the result of the government's commitment to scaled reductions in tariff protection. Realizing that there would be an inevitable increase in foreign competition, domestic firms undertook significant rationalization in order to reduce costs of production. The present Labour government of Prime Minister Hawke is committed to employing the same approach; it will phase in reductions in tariff protection for other industries, in the hope of achieving a degree of rationalization similar to that realized in the whitegoods industry. Reliance on this approach reflects Hawke's commitment to rendering the Australian economy "more competitive and forward looking" ("Australian Leader's Policy," 1985).



The Japanese Policy Approach to Declining Industrial Sectors

The Policy-Making Process

An Overview

In comparison to other countries that are major members of the Organisation for Economic Co-operation and Development (OECD), Japanese policies toward declining sectors have been relatively effective in facilitating substantial adjustment. The image of Japan Inc., in which Liberal Democratic Party (LDP) members, bureaucrats, business representatives and, occasionally, labour representatives participate in a monolithic policy-making mechanism is a major over-simplification. Nevertheless, Japanese policy making is marked by a traditional acceptance of government intervention in the economy along with the active participation of other economic actors in the policy process. There exists "an appreciation that governments have a major part to play in speeding innovation, providing investment incentives, assisting labour retraining, funding infrastructure and providing information on trends in particular sectors and world markets" (McKay and Grant, 1983, p. 10). It is this appreciation and its consequent result, the open and regular lines of communication between government and economic actors, that has enabled policy makers to plan in advance, rather than to take reactive measures when dealing with "sunset" industries: "The Japanese government generally tries to forecast changes in world trade and tries to take advantage of the forecasts in converting its industries before changes in the pattern of international trade make difficult adjustments necessary" (United States, 1979, p. 75). This type of policy making, however, is not always possible. The textile industry, for instance, has been in decline for over 20 years, but exhibits limited signs

of positive structural adjustment. Political expediency, therefore, does play a part in decision making, although the general pattern is one of a rational, consensual, policy-making process.

Policy instruments directed at the goal of efficient structural adjustment have figured largely in this process. In a high-growth economy with traditionally low unemployment levels which has been readily able to absorb the transitional job losses from adjustment, the political pressure to orient policy making toward cushioning the impact of structural change has been muted. In addition, Japanese firms often provide high levels of job security and severance benefits which internalize many of the costs of adjustment. Moreover, the political process itself is biased toward rapid adjustment. Those elements which are affected most negatively by adjustment, such as labour and small business, lack substantial influence in government. Trade unions are disadvantaged politically by the exclusiveness of their connections with parties out of power (Stockwin, 1975, p. 139). The conservative LDP, which has dominated postwar Japanese politics, is aligned with big business and agricultural interests, although it is sympathetic to small and medium-sized businesses. The latter, however, are disadvantaged in that virtually all trade associations are controlled by a small number of large corporations. The avenues of influence are dominated by major business and industry associations whose links to the government have operated in their favour.

Japanese Policy-Making Institutions

Certain characteristics of the Japanese political system have contributed to the tendency of policy to take a long-term strategic approach. One factor is the relationship between the bureaucracy and the cabinet, a relationship dominated by bureaucrats. The LDP, which has retained absolute majorities within both Houses of the Diet, is a highly factional party. Since 1980, there have been several factions struggling for dominance. From 1972 to 1980, five factions, one of which was led by present Prime Minister Nakasone, dominated the party. The factional nature of intra-party politics is institutionalized, particularly in the practice of rotating many cabinet ministers, which is used to apportion the factions equal power in government. Since ministers have only short terms in which to learn about their portfolios, they tend to rely heavily on bureaucrats for information and expertise. Policy thus tends to be longer term and more bureaucratic in nature than would be policy based on short-term pluralist politics (Pempel, 1978).

Japan's Bureaucracy

The Ministry of International Trade and Industry (MITI) and the Ministry of Finance are the two most important ministries relating to industrial policy.

MITI is the most important institution in the policy-making process. It has policy responsibilities with respect to the structure of industry and dislocations that arise in transition, foreign-trade policy, raw material and energy flows to industry, and particular categories of activity such as small business (C. Johnson, 1982; Magaziner and Hout, 1981; McMillan, 1984). At its disposal is a broad range of policy tools including tax incentives, special lending provisions, and administrative direction. However, its structural initiatives, which have focussed on the rationalization and concentration of industries, are subject to some constraints imposed by the Fair Trade Commission (FTC), which administers the *Anti-Monopoly Law*. Moreover MITI budgets must be passed by the Ministry of Finance.

MITI's leverage over industry emanates from the system of "administrative guidance." Ministry officials communicate with business within ministerial advisory committees which incorporate representatives from the business and academic communities. Policy shifts are discussed in a network of conferences which ensure a formal information exchange and allow responsive and incremental policy making by both the bureaucracy and business. Business normally regards administrative guidance, which is a fundamental part of the government/business relationship, as legitimate and in its long-term interest.

The Ministry of Finance sets monetary and fiscal policies and controls government budgeting and tax-collecting operations. The Financial Bureau of the Ministry of Finance manages the Fiscal Investment and Loan Plan (FILP), which channels government funds into industrial sectors via public corporations, such as the Japan Development Bank, which offer loans and grants. This is a major government lever for influencing investment flows in the economy.

The Role of Labour Organizations

Labour organizations lack substantial influence in government. Labour's input is limited to its links with the opposition Socialist Party and the Democratic Socialist Party. Although 35 percent of the work force is unionized, unions are organized on an enterprise basis and often incorporate both management and workers. Strikes are uncommon, since workers identify with their firm, not their job, and because bonus payments are tied to profits which can be endangered by labour militancy. Loyalty to the firm is reinforced by *Nenko*, the lifetime employment system. Although the system applies to less than half the work force — women and most workers in small business are excluded — it is an important job-security measure. In periods of recession part-time workers are laid off first; there is an attempt to avoid the dismissal of permanent employees, who may be transferred to healthy divisions within a firm or to another firm in the industry group rather than made redundant. This system may impose a costly obligation on large corpo-

rations to retain surplus labour, but by internalizing many of the social costs of adjustment it creates incentives for firms to develop flexible mechanisms for the redeployment of surplus labour in business affiliates and to provide retraining for workers whose skills have become obsolete (Tsurami, 1984, p. 256).

The Role of Business Organizations

There are four major business federations which represent business in its dealings with government ministries. Together they incorporate one-half to one-third of all industries. Their influence stems from their comprehensive membership, skilled permanent staff, and connections with politicians. Industry associations are concerned with policy toward individual sectors and typically implement policy. Officials of these associations sit on advisory committees of the MITI. Small business has traditionally been at a political disadvantage in that *Keidanren*, the major business organization, represents big business, and virtually all the industry associations are controlled by a small number of large corporations. However, as big business becomes less cohesive with the entry of foreign capital and the divergence of interests between declining and dynamic sectors, small business has acquired greater political influence. In addition, the LDP is acting increasingly to broaden its constituency and has sought the support of small business with such measures as the 1978 System for Subsidizing Small and Medium Enterprises for Stable Management.

The Role of the Banks

Japanese industry is financed primarily by bank loans; only 20 percent of total investment is held in equity or common shares (Trebilcock et al., forthcoming). Large firms are organized within a banking group comprised of the trust and city banks (the 13 large commercial banks), one of which is a firm's "main bank." These banks extend one-quarter of all loans made by financial institutions in Japan. Each banking group has a trading company which acts as a go-between, buying goods and services abroad and selling in Japan and vice versa. Credit is extended more easily to the banking group's affiliates. The "main bank" will help to reorganize a troubled firm through its ability to control the debtor's management and to impose compromises on other creditors within the group. Ties between banks and their corporate customers are increased by the bank's ability to invest in shares in non-financial companies, by cross-directorships and by the temporary assignment of bank employees to customers' businesses.

Banks are linked with the government through the Bank of Japan within a system which gives the government a certain measure of control

over credit as a policy tool. The Bank of Japan, supervised by the Ministry of Finance, lends money to the city banks, which lend to industry. On occasion the Ministry of Finance may exert leverage over the banks by suggesting which projects to support, a suggestion which the banks rarely resist. Banks need the cooperation of government in the event that they become over-extended, and they accept political guidance as a *quid pro quo*. The system thus rests on common interests shared by banks and the government; the banks play an important role as intermediaries between the state and industry.

The formulation and implementation of policy to deal with declining industries is a process of consultation among bureaucrats, industry representatives and major creditors. The resulting policies tend to take a programmatic approach to industry troubles. This paper will examine both general and sectoral programs directed at labour and capital to cushion the effects of resource reallocation. Textiles, shipbuilding, aluminum and coal mining will be given special attention.

Programs Directed to Labour

Although union membership in Japan makes up 35 percent of the work force, compared to 30 percent in the United States, 31 percent in Canada, and 37 percent in West Germany, Japanese organized labour has been relatively excluded from political influence. This situation has enabled the government to promote structural adjustment and to minimize its contribution to social overhead and welfare. However, the social costs of economic development have recently become more evident, and policies to cushion the effects on labour have been implemented.

The primary burden of reallocating and retraining labour is left to the Japanese private sector. Japan's system of permanent employment, which guarantees workers sizeable discharge payments, thus increasing the costs of shedding surplus labour, means that cutting the labour force is a last resort after other measures have been used. Critical among these measures is the practice of transferring redundant workers to a division within a firm, to a subsidiary, to an affiliate in the industrial group, or to the firm of a supplier customer. Small firms are more likely to shed workers, since they lack the capacity to reallocate workers and often do not belong to a business group.

Japan's unemployment-insurance system is directed at the advancement, rather than the retardation, of structural adjustment. Program benefits are tied to the worker's participation in retraining programs; this provision acts as a positive incentive to shift human resources into dynamic sectors. By authorizing placement and training facilities, the government may relocate workers from obsolete to growth-oriented industries on a nation-wide scale. Since this policy is incorporated into the basic unemployment-insurance scheme, the government can train

and place workers displaced by changes in the national and international economic environment.

At the core of government policy toward labour caught in the process of industrial adjustment is the 1978 *Law for Temporary Measures for the Unemployed in the Designated Depressed Industries* (renewed in 1983), which replaced an assortment of programs designed to subsidize the costs of retraining and retaining workers. The Law provides assistance to workers with at least one year's employment in a depressed industry. These workers are eligible for 12 months of unemployment insurance paid to the worker by the Ministry of Labour. For the most part, this provision applies to workers in small firms, since they are not unionized and are seldom permanent employees. It is costly for Japanese firms to lay off, relocate or require early retirement of workers because these measures entail private costs for the firm. Under the 1978 Law, the Ministry of Labour may now reimburse firms for most of the relocation and retraining expenses incurred in relation to permanent employees, and may subsidize up to 50 percent of the discharge payments given to a temporary, laid-off worker; these payments may reach 85 percent of a worker's salary. The Ministry of Labour may also contribute to an early retirement bonus, as well as subsidizing 10 percent of the first year's salary of newly hired workers who were formerly employed in designated industries. Payments are made by the Ministry of Labour to firms, not to workers; the aim of this procedure is to reduce the exit costs created by the permanent employment system.

Programs Directed to Industry

Government agencies in Japan, such as MITI, have influenced significantly the development of the domestic economy. Government policy has provided cheap capital for investment, tax breaks to sustain liquidity, assistance for research and development, and measures to promote exports. Immediately following World War II, the government created a closed domestic market and controlled links to the international economy. The proponents of development policy argued that government policy could turn a temporary competitive disadvantage into an enduring comparative advantage through policies directed to the accumulation of the physical and human capital that underlies production technologies (Ramseyer, 1981). Thus, the objective of government policy has been to raise real income by assisting the shift of resources to their most productive applications. Programs directed to cushion the transition costs of structural adjustment faced by declining industries have been implemented within this context. The major MITI goal is industry consolidation to increase competitiveness with the shake-out of marginal producers and simultaneous discouragement of investment in, and the protection of, "sunset" industries. Strategy has shifted from protec-

tionism to a regulated free market, through the development of a coherent rationalization policy.

Recession Cartels

MITI policy has sought to promote the rationalization of temporarily depressed industries through cartel arrangements. Production and/or price cartels may now be authorized for three months to set a minimum price level for both the domestic and the export markets as exceptions to the *Anti-Monopoly Law*. These arrangements are administered by the FTC, which has often been in conflict with MITI over MITI's attempts to use "recession cartels" as policy instruments.

Structurally Depressed Industries Law

In May 1978, the *Structurally Depressed Industries Law* was implemented to address, in a comprehensive sectoral framework, situations of declining long-run competitiveness in designated industries. Two types of cartels can be created: a capacity-reduction cartel which legally obligates the industry to carry out planned reductions, and "recession" cartels under which prices are fixed and output is stabilized. Industries are eligible for the program, which is designed to reduce excess capacity by scrapping or temporarily retiring existing facilities if two-thirds of producers petition MITI, and the agency decides to designate the industry as structurally depressed. The law permits MITI to promote and approve the cartelization of an industry (a step otherwise illegal under the *Anti-Monopoly Law*), to coordinate cuts in capacity, and to provide funds to ease the financial burden of discarding redundant facilities.

For each industry designated as structurally depressed, the Law requires the ministry overseeing it (usually MITI, but the Ministry of Transport in reference to shipbuilding) to consult with industry trade associations, major creditors and unions, and then to publish a stabilization plan. The plan specifies both the degree to which capacity will be reduced, and the means by which this reduction will be brought about. The Law's intent is that MITI should rely on the industry's own voluntary initiatives to effect the stabilization plan. Government-instituted cartel agreements, enforceable in the courts, are also often invoked. Where scrapping capacity causes severe financial stress, the Law provides for the creation of a fund, under the joint supervision of MITI and the Ministry of Finance, to guarantee loans from private banks to the troubled industry. This is an attempt to cushion the costs for those firms least able to afford the transition and, at the same time, to direct policy to support the necessity of continued industrial adjustment.

The object of the Law is to encourage the least competitive firms to exit from declining industries. The rationalization program is consistent

with the main thrust of Japanese industrial policies, which aim to ensure that firms remain competitive during the process of transition and transformation in an industry and concurrently to ease the exit of resources from the industry (Zysman and Tyson, 1983, p. 36). The Law has met with opposition from the FTC, consumers, legal scholars and successful firms in designated depressed industries (Ramseyer, 1981). Critics considered it a protective reaction to provide the government with a way to preserve the business of obsolete firms.

Fourteen industries were designated under the 1978 Law. These included aluminum, linenboard, cotton and wool spinning, synthetic fibres, electric-furnace steel, ferrosilicon, chemical fertilizers and shipbuilding. The Law was renewed and amended in 1983, and eleven new industries were added, including petro-chemicals and cement. Many (but by no means all) the industries designated under the Law were energy-intensive (e.g., aluminum) or used petroleum products as inputs (e.g., synthetic fibres, chemical fertilizers), as Japan's dependence on imported oil made these industries particularly vulnerable to the oil-price shocks of 1973 and 1979.

In a recent illuminating evaluation of the Law, Peck et al. (forthcoming) find that in concentrated industries, planned reductions averaged 29 percent of initial capacity and in unconcentrated industries, 20 percent of initial capacity. Between 1977 and 1983, capacity reductions in excess of 15 percent were realized in all but three industries (polyester filament, cotton and electric-furnace steel), and in the four industries with the most ambitious targets (urea, ammonia, shipbuilding and aluminum smelting), more than 25 percent of initial capacity was reduced.

Modest direct government subsidies were entailed, to a total of \$148 million, except in shipbuilding and textiles, where loan guarantees were provided to the industry under plans to finance the purchase and scrapping of excess capacity by the acquisition of smaller firms by large firms in the industry.

For all of the ten industries for which Peck et al. were able to obtain data, the number of workers declined between 1977 and 1983, in three instances by over 50 percent. In total, nearly 48,000 workers left these ten industries: 15.3 percent of the 1977 work force in the industries in question. In addition, 44,000 jobs were eliminated in shipbuilding between 1977 and 1979. Unemployment of workers from the designated depressed industries peaked in 1978, when 47,000 workers (including 25,000 from shipbuilding) were on the unemployment-compensation rolls. This number, however, represented less than 5 percent of the one million workers drawing unemployment compensation in that year; the number dropped from 47,000 to 19,000 in the following year.

The authors conclude that the Law has had a more marked effect on concentrated sectors than on unconcentrated sectors, where planned capacity reductions were more modest and largely ratified likely market

trends in the absence of intervention. They argue that in oligopolistic industries, strategic behaviour considerations may discourage any one firm from being the "first mover" in reducing industry capacity if the reduction may be exploited by other firms which maintain or expand their capacity. Government may thus play a useful role in coordinating industry-wide capacity reductions. In less concentrated sectors, it is difficult to achieve coordination with or without government involvement, and hence the difficulty of greatly influencing market trends. The major apparent failure of policy under the Law has been in relation to electric-furnace steel, where total capacity has actually increased. Resistance by the leading firm in the industry to capacity reductions and the diversion of government subsidies from modernization of residual capacity to increases in total capacity are seen as the major explanations of this failure. Adjustment in the textile sector has also been relatively modest, despite declining comparative advantage. The 1983 Law, which operates until 1988, will provide a broader range of government subsidies to firms in declining sectors to facilitate their adjustment and will permit various forms of business "tie-ups" (production and transportation tie-ups, joint selling agencies); these arrangements are apparently intended to facilitate industry specialization or adjustment-oriented temporary cartelization.

Along with the *Structurally Depressed Industries Law*, the government has also employed tax incentives to assist declining industries. The Program on Investment Tax Credit, established in April 1979 (for 2 years), applied to those designated industries which suffered from structural changes or which faced an urgent need for rationalization. A tax reduction equivalent to 10 percent of the purchase price of machinery and equipment was granted. Tax expenditures on this program were expected to total \$413 million by fiscal 1979 (OECD, 1979, p. 10).

Assistance to Small and Medium-Sized Enterprises

Declining industries in Japan are often those in which small businesses predominate. Small businesses also tend to be economically dependent on large corporations that run the trading companies which market and sell Japanese exports. In August 1971, the *Law for Provisional Measures for Small and Medium Enterprises* was implemented to assist firms affected by Japan's application of tariff preferences to imports from less-developed countries. Smaller-scale firms were entitled to have their adjustment programs financed by the Small Business Finance Corporation, the People's Finance Corporation, or the Small Business Promotion Corporation, on condition that their adjustment plan was approved (OECD, 1975, p. 295). MITI also assists small enterprises to shift their resources to a new industry if their business has been injured by trade changes, technological innovations, raw-material shortages, or com-

pliance with environmental and safety regulations. The above-mentioned government-affiliated institutions grant long-term, low-interest and interest-free loans, and government-guaranteed loans and tax incentives are available as well. In 1973, the criteria for assistance under the programs of the 1971 Law were expanded. Enterprises now are required to facilitate the production of knowledge-intensive goods.

In October 1978, under the *Smaller Business Switchover Law*, the System for Subsidizing Small and Medium Enterprises for Stable Management was introduced. Companies are provided with long-term, low-cost loans through private financial institutions where the government-affiliated Credit Guarantee Corporation places on deposit the funds of central and local governments. Firms are intended to use the loans to move out of declining sectors and to switch over to new lines of activity. This intention is enforced by the requirement for government approval of an adjustment plan before credit is extended.

Regional Development Policy

Regional development programs are in place in Japan for the purpose of narrowing the economic difference between workers in the major Japanese centres of Tokyo, Osaka and Nagaya and elsewhere, and to reduce the strain on available land and industrial resources in major metropolitan centres. Government funds are provided under the Fiscal Investment and Loan Program (FILP) of the Ministry of Finance to the Regional Industrial Promotion Corporation, a government-affiliated organization established to provide low-interest loans to firms relocating in designated areas. MITI has designated approximately 3,000 locations as eligible sites. Assistance is graded according to the degree of the region's industrial concentration and the rate of its population growth. Eligible activities are manufacturing, the provision of oil-storage facilities, and infrastructure development. The costs for which aid may be granted (to a maximum of 50 percent of total costs) include the acquisition or leasing of land or buildings, new or used machinery or equipment, relocation costs, retirement allowances and employee training.

Bridging funds needed before a relocating company receives money from the sale of vacated lands may be provided by the Regional Corporation. Financing is to a maximum of 80 percent of the value of the land to be sold. When a firm is unable to sell the land, the corporation may purchase it, at the vendor's request, and resell it for public use. This program has declined in scale: in 1975, there were 25 cases of financing and purchasing of land for relocation, to a total of \$130.5 million, while in 1979, there were 26 cases to a total of \$94 million (OECD, 1983a, p. 157). Subsidies may be provided to local villages and towns as incentives to accept new industries in their locale. These funds may be used to provide facilities for public use such as gymnasias or town halls. The

program is intended to compensate for noise, pollution and other industrial problems. Relocating firms are exempt from the fixed-asset tax imposed by local governments, which are reimbursed by the Japanese government for revenues lost. The program cost approximately 50 million yen per year in the 1970s (United States, 1979, p. 96). Local governments do not provide tax incentives to attract industries.

The *Depressed District Law* also extends special assistance to unemployed workers in districts with high unemployment. Its provisions are similar to those for workers in designated distressed industries.

Sectoral Programs

The Textile Industry

BACKGROUND

The textile industry is dominated by small labour-intensive firms whose production methods were obsolete by the 1950s. In the 1960s, Japanese economic growth raised wage rates with the result that textiles became increasingly uncompetitive. Textiles were in transition between an export and an import-dominated industry. The transition was delayed by the undervaluation of the yen, which permitted textile exports to remain artificially competitive.

In 1971, the yen was revalued, and textile production became stagnant relative to other manufacturing industries. By 1975, textiles accounted for only 6.7 percent of all Japanese exports, a drop from 27 percent in 1955 and 18.7 percent in 1965 (United States, 1979, p. 96). In 1973, Japan became a net importer as imports held 17 percent of the Japanese domestic market share, compared to 1960, when they had accounted for only 1 to 2 percent of the market (*ibid.*).

GOVERNMENT INTERVENTION

In the late 1960s, it became apparent that the Long Term Arrangement Regarding International Trade in Cotton Textiles, concluded under the auspices of the General Agreement on Tariffs and Trade (GATT) was not conducive to the long-term viability of the textile industry. Government policy focussed on the reduction of excess capacity, long-term, low-interest loans from government-affiliated financial institutions, government-guaranteed loans, and extension of the repayment period on existing loans. From 1956 to 1977, Japan's national government spent \$18 million on the direct purchase of excess equipment which was then scrapped (Ike, 1980, p. 540). Over the same period \$1.7 billion was provided in low-interest, long-term loans to promote the disposal of excess machinery, the modernization of productive capacity, and the grouping

of units of production (ibid.). In 1956, the *Temporary Law Governing Textile Industry Equipment* implemented a registration system for spindles and looms in an effort to reduce production. Firms were not permitted to use unregistered equipment. The system, however, proved ineffective. In 1972, MITI admitted that there were 162,000 illegal looms in existence, or 20 percent of registered loom capacity.

In 1973, the *Temporary Law for the Structural Improvement of Textile Industries* was enacted to encourage restructuring by vertical integration of small firms to increase the value-added of their products and to provide knowledge intensification. The objective of the program was to have upper-stream (production of yarn/thread from raw materials), middle-stream (weaving of thread/yarn into fabric), and lower-stream (production of apparel from fabric) companies merge or coordinate operations, placing emphasis on the production of high-quality apparel. The policy instruments (United States, 1979, p. 94) used to encourage vertical integration were:

- low-interest loans from government-affiliated financial corporations to firms which integrate vertically;
- tax incentives allowing firms to depreciate fully a newly constructed joint facility in 3.5 years, although the facility normally could be depreciated only 90 percent in 7 years; and
- payments of \$50 per worker per month for 12 months to firms in any expanding industry which hired workers who had been displaced as a result of vertical integration.

Small businesses in the textile industry could apply for small business-assistance measures such as those under the *Law for Provisional Measures for Small and Medium Enterprises*, discussed earlier. The labour-assistance measures previously discussed also apply to textile workers, since the industry has been designated as structurally depressed. Under a policy which appears to retard adjustment of labour, textile workers may receive unemployment benefits for two years without vocational training requirements (ibid., p. 80). Workers in the textile industry have not used widely the retraining programs available. In a December 1978 survey of persons released from employment in the textile industry during 1977–78, 44.8 percent remained unemployed, only 6.2 percent had received extended unemployment benefits, and 3.6 percent had received retraining benefits (Ike, 1980, pp. 549–50). Most unemployed persons did not know about available programs, and those who did said that application for assistance was complex. In addition, many firms still in the process of reducing payrolls had shown limited interest.

The number of applications from firms for benefits under the legislation has been small. From 1975 to 1978, only 56 groups involving 3,375 enterprises received assistance to promote knowledge intensification

(Ike, 1980, p. 545). The funds distributed amounted to only 18 percent, 33 percent and 28 percent of the allocated budgets in fiscal years 1975 to 1978 respectively (ibid.). By 1978, only 40 integrations had taken place since the program's inception, each involving approximately 10 firms (United States, 1979, p. 95). There are over 100,000 firms in the industry. MITI claims that in 1974, when the program was implemented, firms were reluctant to borrow in order to integrate, in view of the industry's uncertain economic future. At this time Japan was suffering from the severe effects of the 1973 oil crisis.

In May 1978, the *Structurally Depressed Industries Law* was applied to the textile industry. Synthetic fibre makers, who earlier had stressed the need to scrap excess equipment, settled for a freeze on equipment under an MITI-FTC approved cartel as market demand and prices improved (Ike, 1980, p. 548). A 16-year interest-free loan to trade associations under the Textile Industry Joint Scrapping Plan to buy small firms and scrap their capacity seems partly to explain a significant reduction in the number of small firms in cotton and wool, although reductions in industry capacity in cotton-spinning and synthetic fibres seem to have been quite modest. Recession cartels were organized in the industry in 1977, 1978 and May–September, 1981. The last period was short because of the refusal of the FTC to allow an extension.

THE POLICY-MAKING PROCESS

The political power of the textile industry is considerable. It is Japan's oldest industry, and it is dominated by a large number of small firms whose owners are often engaged simultaneously in agriculture and in other economically significant enterprises. Political pressure for assistance to the textile industry originates from the fact that the Japanese farmer is the backbone of the Liberal Democratic Party because of a riding system which greatly favours the representation of rural areas (Ramseyer, 1981, p. 614). The government has consistently supported agriculture with such policies as price subventions for rice and agricultural product import quotas.

Political power also derives from the important role which small textile firms played in Japan's postwar recovery. Thus, textile producers have had strong ties with the ruling LDP, and the industry is an important source of political support. Pressure from producers for assistance is strengthened by the support of the Japan Federation of Textile Workers' Union which, working through the Democratic Socialist Party, has generally supported the same policies advocated by producer groups. Until recently, Japanese unions were not greatly concerned about unemployment resulting from adjustment, since the country's high-growth economy had been able to absorb displaced workers.

IMPACT OF INTERVENTION

From 1974 to 1978, the Japanese government had invested the equivalent of \$US 2 billion in the textile industry, which remained unprofitable on an industry-wide level (Ramseyer, 1981, p. 614). Profitability in the textile sector has been consistently lower than average profitability in other manufacturing industries (Ike, 1980, p. 541). Profits, however, have followed a cyclical course not necessarily indicative of structural difficulties. One analyst contends that assistance to the textile industry is not warranted because that industry is not structurally depressed (ibid.). Although adjustment of labour out of the textile industry has been eased by the government's policies of assistance, the industry remains highly fragmented and heavily biased toward the production of low value-added yarns and fabrics. Government policies to encourage rationalization and consolidation of production, and to shift the textile industry to high value-added sectors in response to import competition in low value-added sectors, have had limited success. Adjustment policies may have been hindered in their effect by government measures which provide last-resort protection to the industry, such as special fiscal measures to prevent bankruptcy in periods of recession. These measures include loan allowances to prevent bankruptcy, provided under the Small and Medium Enterprises Prevention of Bankruptcies Mutual Relief Scheme.

The Shipbuilding Industry

BACKGROUND

Before World War II Japan's shipping industry was ranked third in the world. Almost destroyed during the war, it became a government reconstruction priority in the 1950s. Under the *Machinery Reconstruction Laws* passed in 1956, companies received aid in modernizing capital equipment. Shipbuilding was given priority because of the obvious need for a strong shipping industry in an island nation, and because steel and labour inputs are the major costs of construction. In the 1950s, Japan had an abundance of low-cost labour, and steel was an important priority.

In 1962, Japanese ships carried only 54 percent of Japan's exports and 41 percent of imports ("Help for Shipping," 1963, p. 153). By the late 1960s, however, Japan was the world's lowest-cost producer of ships. The provision of low-cost steel by Japan's efficient industry, the relatively low cost of Japanese labour, and the large scale of Japanese shipyards made possible by the rapid growth of the industry all contributed to Japan's position of world dominance (Magaziner and Hout, 1981, p. 69). In the early and mid-1970s, Japan launched over 50 percent of all the world's ships, and shipbuilding companies were highly profitable (ibid.). In 1973/74, the industry entered decline.

The collapse of the tanker market was the major cause of the indus-

try's decline, coupled with competition from lower-wage producers such as Korea, Spain, Brazil and Taiwan. The 1973 oil crisis caused ship orders around the world to fall drastically, and many orders were cancelled. Japan's international market share of shipbuilding dropped from 49.7 percent in 1975, to 34.7 percent in 1978 (Magaziner and Hout, 1981, p. 69), but recovered to 45 percent in 1985.

GOVERNMENT INTERVENTION

In the 1950s and early 1960s, shipbuilding was a priority industry which received substantial government assistance as it attempted to gain international competitive dominance. The government formed an industry-development association to assist in the introduction of new technology and to encourage rationalization. In 1959, an advisory council on shipbuilding was established; it authorized tax incentives, interest-rate subsidies on loans to the shipbuilding industry for approved mergers, and an interest-rate subsidy (such as deferral of repayment for up to 15 years) to encourage shipping companies in Japan to buy Japanese ships. The Japan Development Bank provided approximately 70 percent of industry financing at this stage, and approximately 70 percent to 80 percent of all loans provided by the Japan Export-Import Bank were made to the shipbuilding industry (Magaziner and Hout, 1981, p. 69). Tax incentives included provisions to allow the reserves held by shipbuilding companies to absorb price fluctuations to be tax free, special depreciation allowances, the establishment of an export- and investment-losses reserve to avoid taxes, and tax and other financial incentives for investment in overseas-market development.

Government assistance declined as the industry matured in the late 1960s and early 1970s. The government reduced tax subsidies, eliminated export-price subsidies, virtually ended loans from government-affiliated banks, and refused export/import financing. The collapse of the world shipbuilding market in 1973/74 led to a sharp decline in new orders received by Japan. These fell to 9.4 million tons in 1974, after reaching a 1973 peak of 34 million tons. By 1978, new orders had fallen to 6 million tons. After 1974, because of the shortage of work, 37 small and medium-sized shipbuilders went into bankruptcy, and in 1978, Sasebo Heavy Industry, Japan's eighth-largest shipbuilder, almost failed (Kikkawa, 1983, p. 241).

To alleviate the situation, the government again adopted a major policy role. In 1976, the Ministry of Transport established minimum prices for ships ordered after the fall of 1976, in an effort to prevent domestic "cut-throat" competition (United States, 1979, p. 75). In February 1977, the price floors were raised by 5 percent as a concession to the European Community (EC). MITI and the Ministry of Transport monitor the export prices of ships.

The Ministry of Transport has also regulated the expansion of productive capacity by restricting capital investment in shipbuilding firms. Any expansion in capacity of more than 5,000 gross tons is prohibited, while any lesser level of expansion must have Ministry approval (United States, 1979, p. 75). In fiscal year 1977, the Ministry of Transport provided \$750,000 to subcontractors shifting to the ship-scraping industry, a new industry in Japan (ibid.).

With the approval of the FTC, under the 1978 *Structurally Depressed Industries Law*, the Shipbuilders Association and the Shipping and Shipbuilding Industries Rationalization Council agreed to form a cartel to operate until March 1981; the agreement limited each shipbuilder to 39 percent of previous peak output. A second cartel, operative from April 1, 1982 to March 31, 1983, limited output to 51 percent of the previous peak (Peck et al., forthcoming). Following lengthy debate over whether the large or small firms could best bear the costs of capacity reductions, it was agreed that each of the seven largest firms would reduce capacity by 40 percent; the next 17 largest would reduce capacity by 30 percent, the next 16 companies by 27 percent, and the smallest companies by 15 percent (Boyer, 1983, p. 60). Negotiated reductions in capacity under the Law which result in a coordinated effort to cut production are an attempt to dispel the fear of any firm of losing out competitively through a unilateral cut in capacity. Cartelization is intended to support prices to help the companies bear the costs of adjustment within the industry.

Capacity reduction was facilitated by the creation of a Designated Shipbuilding Enterprise Stabilization Association, in which the two shipbuilding associations played a major role. The association purchased nine shipyards owned by smaller firms, which were scrapped. The funds employed were provided by the Japan Development Bank, and a \$5 million loan was raised from private banks. Each shipbuilder must pay 1.3 percent of the price of new vessels to the association until all loans are repaid. (There is no such provision to ensure that loans to the textile industry are repaid.) This requisition represents a levy on the industry to ensure that shipbuilders bear the costs of adjustment. The Japanese government has also instituted measures to stimulate demand, such as low-interest loans for ships purchased by Japanese shipping firms and government purchases.

THE POLICY-MAKING PROCESS

Policies to assist the shipbuilding industry in the 1950s and 1960s used instruments of credit availability to develop the industry. The first reaction to the industry's problems was protectionist, involving such measures as price floors. Recently the attempt to solve the problems of the industry within the framework of the *Structurally Depressed Industries*

Law has been an effort to cushion the transition costs for both labour and capital while accelerating the restructuring of the industry. The Law has been difficult to implement, however, because of disagreements between the industry and the Ministry.

One instance in which political expediency overrode the traditional decision-making process involved Sasebo Heavy Industries, the eighth-largest shipbuilder in Japan. In early 1978, the company announced that it was in serious financial difficulties. The major stockholders, Nippon Steel and Nippon Kohan, Japan's two largest steel companies, decided not to guarantee future loans, and the banks refused additional funds without guarantees. The major ministries involved — Finance and Transport — and the Bank of Japan refused to undertake a rescue. The consensus was that the company should declare bankruptcy. However, the work force in the city of Sasebo, where the company was a major employer, petitioned members of the Diet and the prime minister to intervene. Eventually, the company was bailed out. A financial package negotiated among the banks, major stockholders, and the ministries involved included government loans, a syndicated bank loan from 18 different banks, and a modest capital infusion from the major shareholders. This was premised on a carefully negotiated change of management (Caldar, n.d.). The regular policy-making process which had resulted in consensus that the company should fail was by-passed.

IMPACT OF INTERVENTION

Government policy has played an important role in helping the Japanese shipbuilding industry to cope with adjustment. Following the end of the shipbuilding cartel in April 1982, the number of building berths had been reduced from 138 to 88 (Kikkawa, 1983, p. 243). The work force, also, has been reduced drastically. Unemployed shipbuilding workers have been assisted under special legislation to help labour in designated troubled industries. Even so, it is questionable whether Japan's shipbuilders, who are highly dependent on exports and thus vulnerable to changes in world demand, can remain competitive (*ibid.*, p. 244). Shipbuilding is essentially an assembly industry in which labour accounts for a major proportion of production costs, and in which sophisticated technology is not required. Thus the newly industrializing countries (NICs) have a comparative advantage. Japanese policy to date has tended to buy time for the industry, during which a significant degree of rationalization has occurred. Nevertheless, further adjustments may be necessary if elements of the industry are to remain competitive in the long term.

The Aluminum Industry

Japan has never been an internationally competitive producer of alumi-

num. From 1976 to 1979, imports of aluminum were three times greater than the volume of exports (Magaziner and Hout, 1981, p. 66). Since 1974, the industry has experienced especially severe difficulties.

The oil-price shocks damaged the industry, since Japanese firms generate the electricity for aluminum smelting in oil-fired plants at a cost much greater than the cost of electricity in major aluminum-producing nations such as Canada and Norway. Aluminum imports increased from 24 percent of total supply in 1976, to 56 percent in 1981 (Boyer, 1983, p. 62).

Total financial aid to the aluminum industry has greatly exceeded aid to all other industries designated under the 1978 *Law for Structurally Depressed Industries*. The total is small, however, compared to the losses of the aluminum companies which were \$US 436 million from 1976 to 1983 (Peck et al., forthcoming). Even though the industry is not competitive, for reasons of national security the Japanese do not wish to have to rely entirely on imports for such a basic material.

A stabilization plan was negotiated under the 1978 Law, under which a cartel has been organized with the aim of cutting 56.7 percent of 1977 capacity. The Association for the Promotion of the Structural Improvement of the Aluminum Industry will implement the cartel, which was agreed to only after difficult negotiations between MITI and the industry.

Other measures to assist the industry include a "tariff-rebate" system established in 1982, under which primary producers can import aluminum tariff free up to the amount of capacity they had closed. The benefit of the tariff which, in 1982, was 9.3 percent of the import price, in effect accrues to the domestic importers. The tariff systems (both the exemption established in 1982 and the quota established in 1978, which the rebate system replaced) amounted to a subsidy of \$US 112 billion to the end of 1984, a sum greater than all subsidies under the 1978 law (Peck et al., forthcoming). The government also stimulated demand by financing the Light Metal Stockpiling Association, which bought \$US 246.4 million of ingot from 1976 to 1983 (ibid.). The Japan Development Bank also provides low-interest loans to primary producers and low-cost loans to convert electricity-generating plants from oil to coal. Government subsidies to carry out basic research have been granted to the Research Association on New Smelting Processes for Aluminum.

The Coal-Mining Industry

During the 1960s, petroleum products steadily replaced coal as a source of energy because of cost and environmental advantages. Coal production in Japan fell at the rate of 2 to 3 million tons annually (OECD, 1972, p. 185). To minimize the economic and social effects of the decline of what was once an important industry, policies were implemented to reduce the costs of adjustment. Quota restrictions on oil imports shifted the burden to oil consumers and slowed the process of coal-industry

adjustment. The government also forced the consumption of specific amounts of coal in thermal electric generation, in which a large quantity of coal is used (OECD, 1975a, p. 297). The Coal Region Development Corporation was established in 1962, to grant preferential financing to any enterprises which expanded their activities in the coal regions. Businesses in which displaced coal miners or their dependents accounted for more than 30 percent of total employees were entitled to low-interest loans through the Corporation (ibid., p. 290). In 1962, a coal-mining investigation team was organized by MITI, which began to encourage closure of low-efficiency mines and to assist in improving efficiency in remaining operations. It set an annual production target of 55 million tons by 1977, but this objective could not be sustained because the movement of labour out of the industry was too great. In 1963, a new policy (ibid., p. 297) lowered the production target to 50 million tons, raised the rate of government subsidization for the closure of mines, promoted industrial diversification in coal-producing regions, established a special account to assist the industry with customs duties on all imports of energy resources as the revenue source, and provided that the government would take over loans, amounting to \$500 million, which coal-mining companies had outstanding to banks.

The *Coal Miners' Assistance Law* of 1959 provided aid to miners laid off as a result of conversion within the economy to other energy sources. The program assisted 300,000 workers between 1955 and 1977, providing extended unemployment benefits, relocation expenses, low-rent housing and temporary state jobs (United States, 1979, p. 80). The Employment Promotion Project Corporation is a public body directed by the Ministry of Labour which provides special credits to enable employers to build homes for former workers in depressed industries who have been re-employed in new areas distant from their previous place of residence. Labour has rapidly left coal mining. Employment fell from 294,000 in 1958, to 40,000 in 1971 (OECD, 1975a, p. 295).

Conclusions

A mutually dependent and cooperative relationship exists between political and economic actors which generally has enabled the government to avoid politically expedient, ad hoc responses designed to shelter declining industries. Open and institutionalized communication among the key players permits anticipatory planning (using economic forecasts which reveal changes in market patterns) rather than reactive policy responses, to deal with "sunset" industries.

Japan has taken a programmatic approach, which is, in part, the outcome of long-term bureaucratic decision making, to assist the adjustment of capital and labour in declining sectors. The major policy instruments directed at assisting investors have been applied within the *Law*

for *Structurally Depressed Industries*. The Law encourages mergers and the scrapping of capacity, and allows for government's provision of credit. An adjustment plan is negotiated by government officials, major creditors and the industry. Dislocated labour is assisted within specially legislated programs, such as those within the 1978 *Law for Temporary Measures for the Unemployed in the Designated Depressed Industries*. The purpose of adjustment programs is to encourage economic efficiency rather than to preserve the status quo, or, in the case of labour, to compensate for unemployment only to the extent that laid-off workers are willing to undertake retraining.

Within the industries studied, Japanese policies in the 1950s and 1960s were directed at the protection of a dynamic industry, such as shipbuilding, and at scrapping overcapacity, as in textiles. Policies implemented in the 1970s reflected an attempt to take a more sophisticated approach to developing long-term comparative advantage. Legislation directed at the textiles industry encouraged vertical integration of production. Textiles remain highly fragmented, however, and heavily biased toward the production of low value-added goods, although adjustment out of the industry has occurred. Shipbuilding has regained its strong competitive position, following a decline in the mid-1970s, in part as the result of the application of the *Structurally Depressed Industries Law*, which induced drastic reductions in capacity and major restructuring.

Although the record of Japanese industrial policy is generally one of successful management of the pace and direction of industrial change, a number of industries remain depressed despite intervention. In 1983, the *Structurally Depressed Industries Law* was renewed and nearly doubled the number of designated industries. Only four of fourteen originally designated industries (one of them shipbuilding) have "graduated" from the program, and none of the industries has completed restructuring. Moreover the use of cartels to facilitate industrial restructuring has attracted allegations from international competitors of unfair trading practices. A largely unexplained paradox relates to the reason why cartels which, among other functions, set minimum prices for domestic producers in industries facing substantial international competition do not increase the flow of lower-priced imports, thus exacerbating, rather than ameliorating, the difficulties faced by the domestic industry. One explanation offered for the fact that this result appears not to have occurred in most sectors where cartelization has been employed is that protectionist, "invisible," trade barriers have simultaneously been erected to discourage foreign competition. The existence, nature and significance of these barriers remains a matter of major current controversy (Peck et al., forthcoming).



The French Policy Approach to Declining Industrial Sectors

The Policy-Making Process

The French state has a long history of using explicit policy tools both to influence and to make industrial decisions. *L'état* is a powerful symbol in French politics, representing an independent force in political life and the unified authority of society. Debate over economic policy is conducted in an openly political, not economic, framework, and it is the politically defined industries which feel the state's influence (Zysman, 1978). The acceptance of a strong state presence in the economy has coexisted with the postwar domination of a centre right coalition and thus tends to transcend ideological considerations. The socialist administration of President Mitterrand, elected in 1981, has pursued similar policies, despite an initial wave of nationalization. In so doing it has partly reflected current debates in which views that would decentralize decision making, and reduce the direct role of the state in business have gained increasing currency. Current efforts to restructure and reduce the size of the steel industry, despite significant loss of jobs, reflect these influences.

The traditional view of French policy is one of taking decisions within the framework of a coherent indicative plan. During the 1950s and 1960s, when France was experiencing high levels of growth (an annual average GDP growth rate of 5 percent), the Plan attempted to focus industrial development. The fifth Plan (1955–70) developed the strategy of “national champions.” Assistance was granted to selected firms within the framework of government-firm “contracts.” In combination with a policy of encouraging mergers and concentration, the state created the business partners with whom it would deal. During the 1970s, when the

rate of growth declined and the French economy was forced to take account of its increased vulnerability to the external environment (a vulnerability previously accentuated by membership in the European Community (EC) and the decolonization of Africa), the Plan became more important as a process than as a policy framework. In this period France's economic orientation shifted away from the "franc zone" toward the EC. In 1956, 32 percent of French exports had gone to franc-zone countries; by 1972, this figure had dropped to 5.3 percent (Morse, 1977, p. 73).

The heritage of planning is an increasingly close relationship between the public and private sectors. Through the planning exercise, state and big business entered a partnership, *l'économie concertée*, which involved a formal process of negotiation and consultation. Business, which lacks an all-encompassing organization other than the loosely structured Conseil national de patronat français (CNPF), was represented by the trade associations or large firms themselves. Labour representatives were excluded from the process. The exercise was an efficient information-gathering mechanism for the state, which better prepared policy makers to react to the need for adjustment. Collaboration with the private sector also gave the process legitimacy, although the exclusion of the unions has resulted in conflict, as in the major industrial disruptions of May 1968. The unions asserted that the Plan was directed too closely to industrial development, to the exclusion of social concerns. A tradition of weak relations between the state and the unions and the fragmentation of the unions has not encouraged socialization of the costs of adjustment.

"Deplanification" — the dismantling of planning institutions, reductions in the scope of plans, and a return to economic liberalism — occurred under Prime Minister Raymond Barre, following the defeat of the French Left in the elections of March 1978. Price controls were abolished in September 1978, and a reform of the tax laws encouraged investment in the stock market. The government became more deeply interested in emphasizing the role of market signals, rather than in direct intervention. The Planning Commission, which had played a central role in policy making, was replaced by the Conseil général de planification (CGP), which virtually abandoned the "concertation" process. The CGP is a highly political body composed of the president, the prime minister, the ministers of Economic and Financial Affairs, Labour and Employment and the planning commissioner. Previously, planners were, at least in principle, independent of the government. Planners are no longer a part of the inner core of French public administration. In recent years, the French government has taken a more flexible approach to the economy, coordinating policies through bureaucratic agencies rather than attempting to develop a highly concerted national strategy. The CGP remains active in meeting with industry groups and reviewing longer-

term issues and prospects in various industries, but its focus is prospective and less directly geared to the formulation and implementation of detailed large-scale industry plans.

The decline of the Plan went hand-in-hand with a shift in economic policy toward more selective assistance to industry under the sector-plan concept and away from general industrial development. The French state has powerful instruments to direct selective assistance, and these include control over the banking sector. The state's influence in the financial system is derived from the direct ownership of financial institutions, insurance companies and the savings *caisses*, and from the weakness of the financial markets. There is an enduring tradition of private bank involvement in the initiation and management of business, and the *banques d'affaires* are experienced in effecting industrial reorganizations. The banks play a vital role as intermediaries between the state and industry. Banks are often "locked-in" to shareholdings in firms from which it is difficult to disengage during crises. The state does not encourage disengagement, but favours bank involvement in crisis management (Dyson and Wilks, 1983a, p. 263). State control over the allocation of capital may exert significant influence over private investment decisions, since French industry derives 80 percent of its capital from state-owned financial institutions (Trebilcock et al., forthcoming). The *Direction du Trésor*, or Treasury, within the Ministry of Finance, is the department responsible for implementing interventionist financial policies. The Investments and Participations section of the Trésor manages crises in declining sectors.

France has well-developed institutional mechanisms for crisis management deriving from a long tradition of *dirigisme*, and a network of relations between government and business élite who share similar educational and social backgrounds. Unlike West Germany which is characterized by "closed" private sector crisis management involving the banks and industry, France is characterized by "closed" public sector management which involves the bureaucratic élite, who insulate themselves from political pressures, and the Trésor, which has a coordinating role (Dyson and Wilks, 1983a, p. 263). Both nations have depoliticized effectively the process of crisis management by working within technocratic institutions which partly, at least, insulate policy makers from demands to retard adjustments. French policy, although inclining toward protection, has attempted medium-term strategic planning and has effectively coordinated policies toward specific sectors. It is also, however, characterized by ad hoc responses to troubled firms and industries.

A study of the French approach to adjustment in the steel, shipbuilding and textile industries makes it evident that assistance has normally been conditional on concentration and rationalization, although

rationalization has been a more recent concern. During the 1960s, under Pompidou and Giscard d'Estaing, emphasis was placed on mergers and concentration, often to the neglect of efficiency within firms.

General Programs

Fiscal Instruments: Concentration Incentives

Concentration through merger or association has been a prominent part of French policy to promote structural adaptation. France had the highest rate of mergers in Europe in the postwar period (Suleiman, 1975, p. 26). This policy orientation follows from the objective of creating large efficient firms. France was not as deeply concerned with domestic competition as with strong national firms which could compete internationally. In July 1965, legislation was enacted which provided for special tax treatment designed to encourage mergers. The main provisions are as follows (OECD, 1978, p. 79):

- no immediate taxation of capital gains on fixed assets;
- taxation in the hands of the acquiring company of net capital gains on non-depreciable fixed assets is deferred until such time as [the assets] are disposed of by the company, such capital gains then being calculated by reference to the value of such assets as shown in the balance sheet of the company taken over;
- the requirement that capital gains (whether short or long-term) arising on depreciable assets to the merger must be added back to the acquiring company's profits and subject to tax at the full rate of 50 %, is mitigated by allowing such adding back to be spread over 10 years; however, the company taken over may opt for all or part of any long-term gains on its depreciable assets to be taxed in its own name at the reduced rate of 10 %, and in this case the capital gain on which the acquiring company has to pay tax over 10 years at 50 % is of course reduced to that extent;
- the acquiring company is allowed to show the depreciable assets of the company taken over at the value assigned to them for the purposes of the merger and thus to depreciate them to a greater extent than would be authorized on the basis of the value at which they were shown in the last balance sheet drawn up for general purposes.

Financial Instruments: Interministerial Committees

A major policy initiative in the 1970s was the creation of interministerial committees as mechanisms of coordination of government action. The committees are centralized, in the tradition of French policy making, and authoritative. The interministerial committees are important for crisis management, but also because they represent the dilemma of Giscardian industrial policy: the desire to leave industry to market forces and resist the pressures for intervention, while creating sophisti-

cated bureaucratic mechanisms to deal with crises (Green, 1983, p. 173). Prime Minister Raymond Barre's policy orientation was toward greater economic liberalism and the promotion, not prevention, of industrial change. Yet adjustment was to be assisted by government, as is evident in France's treatment of the steel, shipbuilding and textile industries. These committees are powerful because they are located within the Trésor, and because the prime minister chairs the Interministerial Committee for the Development of Strategic Industries (CODIS). The Ministry of Industry has very little discretion over resource allocation. It screens applications for assistance from industries and firms, and then presents these to the Trésor. The Trésor may be the most important agency, since it presides over the allocation of capital to the private and public sectors, and supervises a number of state-owned financial institutions, such as the Crédit National. Both departments must work also with DATAR, the regional development agency. The creation of interministerial committees reduced bureaucratic conflict, and made coordination of industrial policy decisions more feasible.

Firm-Specific Policies

In 1974, the Comité interministériel pour l'aménagement des structures industrielles (CIASI) was created to rescue firms that were perceived as basically efficient, but in temporary difficulties following the 1973 oil crisis. Where a firm's difficulties were perceived to be the result of poor management, the CIASI attempted to persuade a strong firm in the same sector to initiate a take-over. The alternative was to replace the management and shut down the least efficient part of the business. Efforts to reorganize involved private capital, with a maximum of 10 to 15 percent of the total cost paid by the state. Private involvement was to ensure that banks and shareholders had a part in the company's long-term viability. CIASI procedures are unusual in being swift, flexible, and straightforward (Green, 1983, p. 177). Weekly meetings of ministers and senior officials from the key economic ministries and financial institutions, including the Governor of the Bank of France, ensure rapid decisions. An agent of the Trésor coordinates the administration of the procedure, which involves a quick and detailed appraisal of the troubled firm. In the first two years of its existence, CIASI handled 90 cases per year; in 1980 the figure grew to 649. In its first three years (1974 to 1977), CIASI assisted 431 firms, the same number that it aided in 1980 alone. In 1980, the proportion of rescues by take-over rather than by bail-out procedures had increased 50 percent since the inception of the program (*ibid.*). CIRI, the Interministerial Committee for Industrial Restructuring, replaced CIASI in July 1982. Within CIRI six regional committees were established to decentralize decision making.

In March 1979, the Interministerial Committee for Industrial Develop-

ment and Support of Employment (CIDISE) was created to assist successful small businesses to develop new products and capture new markets. CIDISE represented a policy shift from the traditional encouragement of mergers at the expense of small business, and the state's preference to foster links with big, rather than small, business. CIDISE was modelled on the CIASI procedure of private and public capital inputs. In its first 21 months, it helped 431 investment projects with a total value of 4.30 billion French francs (FF), at a cost to the state of 626 million FF (Green, 1983, p. 179). In 1980, the expenditure of 3.3 billion FF was estimated to have generated 10,400 new jobs, at a cost to the state of 500 FF per job, a much lower amount than that expended in other job-creation schemes (*ibid.*). A second agency which is an offensive policy instrument is the Interministerial Committee for the Development of Strategic Industries (CODIS). CODIS selects strategic sectors, defines a strategy, chooses a firm to spearhead the strategy, and coordinates state action to assist the firm, using a state-firm development contract. The procedure involves direct intervention in private sector investment decisions, although CODIS' strategies are indicative, not mandatory. CODIS emphasizes high technology, such as biotechnology, microelectronics and computers, although with mixed success, particularly in the last-mentioned case.

Regional Development

The French state has not favoured extensive use of general regional investment incentives because these incentives do not provide significant leverage to control or direct the business plans of aid recipients (Suleiman, 1980). In September 1978, the creation of the Special Fund for Industrial Adaptation (FSAI) to assist the conversion of regions dominated by declining industries which had been affected severely by the recession permitted the state to assist depressed regions, while asserting control through the new mechanism of the *prêts participatifs*. FSAI was administered by a committee modelled on CIASI. Its administration was a policy turning point in that subsidies granted under the program were not to be tied to job-creation targets; this arrangement had always before been a central feature of regional development policy. Capital investment in the region was to be financed by loans and grants of up to 50 percent of total cost.

FSAI introduced the *prêts participatifs*, long-term loans of from 17 to 20 years, at a subsidized rate of interest, which are repayable only if the firm attains a specified level of profitability. One of the problems with the subsidy has been that firms have overestimated this level to delay repayment. The loan becomes a part of the company's capital for its duration and thus provides the state with holdings in private companies. The *prêts participatifs* became an important policy tool adopted by the CIASI and other committees for use in crisis management.

Employment Policy

France has made some attempts to increase labour mobility so that labour may respond to changing industrial conditions. In 1971, an Act was passed which established vocational training as part of recurrent education. All enterprises which have signed a training agreement are obliged to grant training leave to all workers who request it, provided that the hours of leave do not exceed 2 percent of the hours worked in a year. Government financial assistance to attend training courses is granted to workers over 18 years of age who have been dismissed or whose jobs are threatened, and to those who wish a broader opportunity for access to new jobs in growing sectors. Participants in training receive no unemployment benefits, but are paid up to 120 percent of the minimum wage. The program is administered by the Ministry of Labour through the Association pour la formation professionnelle des adultes; government, employees and employers are represented equally in the management of this body. Employers contribute over 1 percent of total annual payroll costs to training, and this figure is increasing.

The main objective of French employment policy is to promote full employment. This policy has often conflicted with the economic objective of shedding redundant labour and reallocating it to other sectors. The receipt of benefits in any program is not contingent on participation in a training program. Representatives of the steel industry have charged that the industry's difficulties have been perpetuated partly as a result of the government's employment policy which has prevented adequate rationalization.¹ Following the events of May 1968, legislation was passed which made it difficult to fire workers. French firms may not discharge workers without prior notice; the duration of that notice depends on the number of workers to be laid off. They must consult their "Committee of Enterprise," composed of union and worker representatives, to discuss the need for, and the terms of, redundancy, and they must receive permission from the Ministry of Labour to lay off workers. France's partial unemployment program provides an alternative to redundancies. Under this program, all workers share the cost of redundancy, rather than allowing a subset of the work force to bear the full cost. Under the program, short-time workers receive 50 percent of their regular wages for the total number of hours lost below 40 hours per week, but no employee may be paid for more than 400 hours. The government will pay 90 percent of the cost of this program if the employer agrees that no other layoffs will be made for the following six months. This arrangement gives employers an incentive to retain workers whose wages are government subsidized while they work short time. The Minister of Labour must determine whether the need for short-time work is genuine.

Unemployment benefits are available to maintain the income of redundant workers. Benefits may reach 60 to 75 percent of previous earnings for a period of 52 weeks if the worker has been employed for six months.

Workers on the low end of the earning scale may receive up to 90 percent of the minimum wage. If a worker has worked fewer than six months, benefits stand at 40 percent of previous wages. Unemployment benefits are universally applicable and do not depend on previous contributions. Before changes were made to the system in July 1979, benefits could be received only if adequate contributions to the fund had been made. To encourage early retirement with the object of creating jobs, workers who have reached the age of 60 receive unemployment benefits supplemented to provide 80 percent of net previous wages until age 65, when regular retirement programs take effect.

Sectoral Programs

The Steel Industry

BACKGROUND

From the inception of the steel industry in about 1870, it took world producers 57 years (to 1927) to produce 100 million tonnes of steel; the second 100 million took 24 years, the third eight years, and the sixth was produced in two years, from 1973 to 1974 (Walter, 1979, p. 156). In 1974, there was a world-wide steel crisis; its full impact was felt in 1975. Demand for steel was in decline, but it was difficult to cut capacity because of capacity increases initiated in the buoyant 1973/74 period. New producers such as South Korea, Brazil and Australia also contributed to the excess capacity. By 1979, overcapacity at the world level reached 87 million tonnes (OECD, 1980, p. 225).

The situation in the French steel industry reflected the world decline. The rate of steel consumption fell permanently as France became highly industrialized; as a result, the elasticity of demand for steel in relation to gross national product (GNP) declined (OECD, 1980, p. 225). Yet successive Plans sought to increase the capacity of the French steel industry. In 1946, the industry had produced 4.4 million tonnes; by 1974, that figure had reached 27 million, despite a decline in the mid-1960s (Stoffaes and Gadonneix, 1980, p. 410). During this period the work force, too, had grown to 158,000 workers, who were concentrated regionally in areas such as Lorraine. Productivity was low in the industry compared to that in other producing nations. In 1974, France produced 175 tons per year per worker, compared to the United States' 252 tons and West Germany's 240 tons (*ibid.*, pp. 413–14).

In 1975, production fell by 16 percent to 23.4 million tonnes, and in 1982, it dropped to 18.4 tonnes (Messerlin and Saunders, 1983, p. 53). Estimated capacity of the industry stood at 29.6 tonnes in 1982. World prices collapsed because of severe competition, and France felt the effect of its failure to modernize or reorganize during the 1960s. To create

a highly concentrated large-scale industry, French steel producers had focussed on mergers, although these mergers had tended to create holding companies rather than more efficient production units able to capture fully economies of scale. Steel producers, too, were concentrated in Lorraine and held large interests in the region's iron-ore fields. Resources were devoted to the development of iron-ore mining and iron production to meet import competition in iron ores, and thus strengthen the firms' position as producers of iron for steel making. In 1974, the French steel industry's medium- and long-term debts had accumulated to 24,000 million francs, an amount equal to two-thirds of a turnover of 36,000 million francs (Stoffaes and Gaddoneix, 1980, p. 415). In 1975 and 1976, the industry lost 4,000 million francs, which increased to losses of 6,000 million francs in 1977; by that year medium- and long-term debt stood at 38,000 million francs, a figure greater than industry turnover (ibid.) In the same year Usinor and Sacilor, the two principal firms, were cited in *Fortune* as the biggest money-losing private enterprises in the world. In 1984, they remained France's biggest money-losers.

The industry continued to resist change in the late 1970s, but was forced to restructure. Usinor and Sacilor were nationalized indirectly in 1978, when the state acquired a 67 percent interest in the companies; they were officially nationalized under Mitterrand in 1981. Mitterrand had also cut the amount of subsidy to Usinor and Sacilor while the ability and desirability of supporting a steel industry was debated in France.

GOVERNMENT INTERVENTION

Steel was regarded as a vital industry in postwar France and was one of the six basic sectors of the first national plan, of which the focus was reconstruction. In the immediate postwar years the state held a near-monopoly on investment funds and was able to allocate directly capital which was channelled to France through the Marshall Plan. The industry responded, and production grew steadily. In 1952, France signed the Treaty of Paris, which created the European Coal and Steel Community (ECSC). This treaty ended the insulation of the French steel industry from international competition.

The first aim of the ECSC was political: to establish as strong a link as possible between France and West Germany in industries regarded as basic to defence and economic growth (Messerlin and Saunders, 1983, p. 59). The ECSC sought a balanced integration of national markets, not free trade or unfettered competition. Price competition among member nations was softened, and domestic trade increased through the regulation of prices by the High Authority of the ECSC. This development corresponded with the careful control over steel prices in France, which prevented the receipt of adequate profits for investment. France's steel industry did well under these conditions until 1959, when it began to

decline. By 1964, the industry was in crisis, unable to cope with the international competition which had revealed its structural weaknesses. From 1960 to 1964, prices fell, while capacity increased by 34 percent, and production increased by 17 percent (deWitt, 1983, p. 235). The industry's debt-to-equity ratio moved to 70 percent from the 1960 figure of 46 percent, while cash flow fell from 12.5 percent of turnover to 6 percent (*ibid.*). The severely depressed state of the industry prompted government assistance within the framework of the Fifth Plan. The Fifth Plan (1965–70) initiated the “national champions” approach to industry and singled out steel as a priority. France's policy objective was to create companies of world scale, characterized by modern technology, competitive costs, and rational financial and investment management. The Plan was optimistic and envisaged a period of expansion, investment and concentration in the steel industry (Messerlin and Saunders, 1983, p. 66).

The French state had no desire to be solely responsible for the implementation of policy under the Plan. Following unofficial negotiations involving the Ministries of Finance and Industry, the Planning Commission and the steel industry association, *Chambre syndicat de la sidérurgie française* (CSSF), a formal approach was made to Prime Minister Pompidou in 1965, with a plan to modernize and rationalize the industry. In a government attempt to shift part of the responsibility for economic management, Pompidou proposed a timetable plan of mergers and specific investment projects to be implemented under the supervision of the CSSF as a condition of government assistance. The steel industry had blamed its financial crisis on strict government price control; as a result, the CSSF had demanded financial aid to enable the industry to be internationally competitive. In July 1966, the Steel Agreement or *Convention-générale état-sidérurgie* was finalized. Analysts of the Agreement differ in their opinion of it. Some see it as the forerunner of “state-to-firm” contracts which became a prominent feature of French industrial policy, since restructuring was to be embodied in separate agreements between the state and each steel firm (Green, 1983, p. 170). Others maintain that the Agreement was not widely imitated, since few industries found it possible to work so closely with the government to reorganize an entire industry (Hayward, 1972, p. 296).

Under the Agreement, the government was to provide investment funds at subsidized interest rates for several years; it was also to reduce transport costs for steel products and assist with labour adjustment through job-training and income-maintenance schemes. The industry accepted the need for concentration and rationalization which involved the construction of new steel plants and the closing of old plants.

The implementation of the Agreement proceeded through the 1970s. Two modern integrated plants were constructed at seaboard sites at Dunkirk in the North and on a greenfield site at Fos-Marseille in the South. These were intended to replace old plants in regions such as the

Nord and Lorraine. Basic oxygen furnaces were introduced widely, as were modern sheet-rolling mills and continuous-casting equipment. The construction of the plant at Dunkirk increased Usinor's capital intensity and raised the proportion of output produced by the basic oxygen process from 53 percent in 1970, to 75 percent in 1974 (Messerlin and Saunders, 1983, p. 68). A number of mergers were completed to further the goal of concentration. Usinor and Lorraine-Escaut were merged, as were De Wendel and Sidelor (now Sacilor). The latter merger involved a major rationalization in the process of which 11,000 of 60,000 workers were laid off. From 1966 to 1975, the number of steel firms was reduced by half (*ibid.*). Production increased by 15 percent from 1966 to 1969, while employment fell by 15 percent, and output per worker-hour increased by 35 percent (United States, 1979, p. 66).

There were, however, a number of economic and social obstacles to modernization. Although, from 1968 to 1975, the steel industry received 2.7 billion francs in the form of concessional 20-year loans through the Fonds de développement économique et social (FDES), a sum amounting to one-fifth of the total outlay of the steel firms in this period (Messerlin and Saunders, 1983, p. 67), weak demand and insufficient competitiveness limited the ability of firms to finance new projects. In addition, the traditional separation between the producers of crude steel and the producers of finished steel products hindered vertical integration. Large steel consumers also were unwilling to see mergers reduce competition among their suppliers. A social dilemma existed in that modernization required new capacity, while productivity required the closure of outmoded plants when new facilities came onstream and the elimination or relocation of employment in those plants. Thus the intended rationalization and specialization at the plant level did not always occur, and the new firms were a mixture of old and modern plants with high operating costs, in part because the modern plants could not be used at full capacity. By the mid-1970s, the problem of adjustment remained severe in Lorraine, where steel was the principal industry. The government avoided confronting the problem, since industrial development was perceived as the source of jobs and the means to combat unemployment. Officials were slow to realize that increased capital intensity must imply declining employment.

In 1975, a crisis hit the industry. Production fell by 20 percent to the 1969 level, declining by 28.2 percent in Lorraine and by 22 percent in the North (Esser et al., 1982, p. 280). The capacity utilization of the industry was 63.5 percent (*ibid.*). The stagnation of output demand and productivity, in addition to increasing debts, forced the government to act. Employment had not been significantly reduced, declining by only 1,800 positions from 1975 to 1978, as compared to 10,000 positions in West Germany (Cohen, Galbraith, and Zysman, 1982, p. 70).

Although the government remained optimistic and oriented to the

expansion and modernization of the industry, the "Ferry Plan" of 1977, while maintaining existing capacity, intensified rationalization efforts with the reduction of 16,000 jobs. Nevertheless, the government was required to act with political caution, since it could not risk an electoral victory of the united left socialist-communist coalition in the March 1978 elections. When the left was defeated, the Barre government immediately formed the "Giraud Plan" (named after Industry Minister André Giraud), which involved a radical shrinkage of the industry. Raymond Barre acted in the spirit of economic liberalism with the intent of using restructuring to ensure that the steel firms would be responsible for their own decisions and less reliant on the state. If the industry was to become competitive, steel must be manufactured under competitive cost conditions. At the time of reorganization, French steel firms devoted 12.4 percent of their turnover to the payment of interest on debts; by comparison, West German firms devoted from 3 to 6 percent of turnover to this purpose (Stoffaes and Gadonneix, 1980, p. 410). The Plan was carried out by the state to the exclusion of enterprise and union representatives. All aspects of the restructuring were arranged within the Trésor and the closed financial community, without debate in the National Assembly. The operation "illustrates the extraordinary economic power of the French State, operating through its influence over the financial system" (ibid.).

Under this plan, all steel firms were combined into two giant holdings, Usinor and Sacilor, which remained nominally within the private sector; the management of the two firms, however, was government appointed, since the government had a 67 percent interest in both firms and was given explicit instructions to produce a restructuring plan. The plan was to include a drastic reduction of the labour force, shutdowns of old plants, and increased production of high value-added products. The financial package involved a *de facto* rationalization of the two companies, which between them accounted for approximately 75 percent of crude steel production. The government agreed to honour the bonds that the industry had issued in the 1970s to ensure that confidence would not be lost among small private investors. The debt claims of the FDES, Crédit National and various loan groupings of the iron and steel groups were converted into special loans: the *prêts participatifs*. Major banks and financial institutions which had made loans to the industry were not coerced into accepting the plan, but the banks and the Trésor are normally cooperative with one another and interdependent. In the French financial system, all credit is channelled through a small number of very large institutions: the Caisse de dépôts, five large commercial banks, the National Agriculture Bank, two business banks and the government. Although the banks are nationalized, they are run in a commercial manner. The government influences the system by setting lending priorities for banks, limiting their total credit extension and

controlling the cost of funds. Overseas borrowing by French firms is also controlled. Therefore the financial system constitutes a key enabling condition for implementation of industrial policy (Cohen, Galbraith, and Zysman, 1982, p. 72).

The Caisse d'amortissement pour l'acier, a sinking fund to be maintained with Trésor funds, was established to replace the industry's creditors; this move enabled the government to avoid dispossessing the private holders of bonds in any of the institutions. Two finance companies were established with a total capital of 2,000 million francs to take majority holdings in the iron and steel corporations to the exclusion of former shareholders (the Denain-Nord-Est Lonevy and Marine Wender holding companies). Stocks in the new companies were so allocated that banks hold 30 percent, the Fonds de développement social et économique holds 15 percent, the GIS 15 percent, the Caisse de dépôts 30 percent, and the Crédit national retains 10 percent. The financial package involved the state financial organizations and private shareholders in a joint public-private rescue. The overall cost of the plan and the redundancies it created are estimated at 50 billion francs (Messerlin and Saunders, 1983, p. 69). In 1978 alone, the state wrote off 9 billion francs' worth of steel debts and covered private debts in the amount of 13 billion francs (deWitt, 1983, pp. 236, 239). From 1970 to 1978, the French state provided a total of 6,643 billion francs in specific sectoral aid to the steel industry (*ibid.*).

The rescue had serious regional and social consequences as redundancies proceeded. From 1975 to 1982, the total labour force in French steel declined by 40 percent, while employment was cut from 150,000 to 105,000 workers between 1978 and 1980 (Cohen, Galbraith, and Zysman, 1982, p. 71). The cuts led to violent confrontations in Lorraine, in early 1979, between steelworkers and police. Labour unions demanded that the costs of redundancy be socialized, since the government had assisted capital by assuming a great proportion of the industry's debt. The result was that labour was compensated by lump-sum payments to the equivalent of \$US 12,500 per worker (*ibid.*). In essence, economic efficiency goals, long secondary to the objective of full employment, were the objectives of the 1978 restructuring plan. During the 1970s, state policy had tended to retard adjustment through the maintenance of old capacity and redundant jobs. However, government policy during this period also enabled the industry to build modern facilities for the future.

In the autumn of 1981, President Mitterrand formally nationalized Usinor and Sacilor, although approximately 4 percent of company shares remain privately held. In 1982, the two companies received 2,800 million francs in government assistance, and this amount rose to 6.44 billion francs in 1983.² On March 5, 1983, Mitterrand announced that the companies would receive only 5.5 billion francs in fiscal 1983/84.³ He has provided further evidence of his desire to modernize "lame ducks" in a

plan announced in March 1984.⁴ The government proposes to cut the steel labour force by 11,000 workers. Adjustment will be eased through early-retirement schemes, a two-year retraining leave under which participants will receive 70 percent of earnings and a regional development-assistance plan to aid areas, such as Lorraine, which depend heavily on steel production.

THE POLICY-MAKING PROCESS

The politics of assistance to the steel industry paralleled the emphasis on concentration, modernization and expansion contained in the first six National Plans. The government repeatedly adopted an optimistic approach to the industry, in an effort to achieve full employment through industrial development. In the mid-1970s, the government was restrained from initiating serious rationalization by the threat of a united French left and a long-standing policy goal of full employment. When the left was defeated in the March 1978 elections, Prime Minister Raymond Barre took an offensive, adjustment-oriented approach to the steel industry. This policy approach has been maintained under the administration of President Mitterrand, although Mitterrand has increased the use of policy instruments to decrease adjustment costs for labour. It has not been politically acceptable to destroy regional economies by allowing the steel industry to fail.

The steel industry has been relatively passive politically as the government has intervened to ease adjustment. This stance is in the tradition of private sector reliance on state aid to attain competitiveness. The steel industry has been confident that the impact of its failure would be too great for any government to consider. Steel has been singled out consistently by French governments for special assistance as a vital industry and has become an integral element of the state-industry complex.

French policies are constrained by the Davignon Plan of the EC which was implemented in 1977, following French, British and Italian requests that a system of external protection and internal stabilization measures be created for the steel industry. The French were the first to request that a "manifest crisis" be declared in the industry. The Davignon Plan established a system of minimum prices for steel products for which the market was particularly depressed, and guidance prices for all steel products. In 1978, a system of voluntary production quotas was negotiated with all EC steel firms. Following the 1980 world-price collapse in steel, the European Commission declared a "manifest crisis" to strengthen its powers of intervention. The Commission introduced compulsory production quotas accompanied by a system of inspections and fines. The result has been a fall in output and a recovery in prices, although the 1982 market collapse led to a price softening. EC steel producers are also protected by an "effective" tariff of approximately 12

percent, although the normal Common External Tariff on steel products is only 5 to 7 percent. Voluntary Restraint Agreements have also been negotiated on steel exports with a number of nations such as Japan. EC action is highly protective and has the effect of retarding adjustment within national steel industries. France has used this external protection to buffer the costs of internal attempts to adjust.

IMPACT OF INTERVENTION

Nationalization of the steel industry and the concentration of the industry into two firms have radically altered the industry's structure. New management in Usinor and Sacilor has introduced important structural changes, centralizing production and enforcing a greater degree of specialization within the firms. Lorraine remains an important plant site and an obstacle to full modernization, since it is a non-coastal site and cannot be fully integrated. Adjustment, although slowed in the 1970s by policies intended to maintain employment and increase capacity, has proceeded since the late 1970s. Employment in the steel industry has experienced a fall second only to that of the United Kingdom within the EC, from a level of 157,000 persons in 1975 to 125,000 in 1979, to 97,000 in 1982 (Messerlin and Saunders, 1983, p. 58). Production has also declined steadily from 27 million tonnes in 1974 to 18.4 tonnes in 1982. Usinor and Sacilor remain important producers; their output rose respectively, to 6.7 percent and 4.5 percent of EC steel production in 1979 (*ibid.*, pp. 53, 57). Rationalization within these firms has continued as plants are closed down and new plants, such as those at Dunkirk and Fos-Marseille, operate at higher levels of capacity.

The Shipbuilding Industry

BACKGROUND

The French shipbuilding industry is characterized as "medium technology," utilizing labour-intensive production processes. Competition within the industry is intense, and economies of scale are the only barrier to entry. Competition exists primarily with regard to credit terms. To continue production, shipyards need credit in the form of progressive payments from shipowners; if the government subsidizes payments, the shipyard can offer more competitive terms. Shipbuilding is a highly competitive industry, in part because of the open registry or flags of convenience used by shipowners of many nationalities. As a result, there is no protected domestic market for ships.

Demand for ships depends on the volume of seaborne trade generated by the overall level of world economic activity and the replacement demand for scrapped ships. Since 1975, there has been a downturn in

world trade, and its greatest impact has been on the tanker market. Because the world fleet is relatively modern, there is also limited replacement demand. The severe collapse of the worldwide shipbuilding industry in the latter half of the 1970s was an effect of the recession. By mid-1977, orders were being placed at 25 percent of estimated world shipbuilding capacity, a development which increased the severity of competition (United States, 1977b, p. 6). In 1982, the world fleet declined for the first time since the 1930s (Mottershead, 1983, p. 88). Seaborne trade was at the 1972 level, but world shipbuilding capacity had increased by 75 percent.

In 1975 France, ranked fifth among the world's shipbuilding nations, in terms of the percentage of world gross registered tonnage (GRT) produced. (GRT is a measure of total cubic capacity.) France experienced only a slight reduction in its world share of GRT production during the crisis. Shipbuilding completions fell drastically, however, over the same period, even as France began to specialize in liquefied natural gas carriers (LNGs) in an attempt to achieve greater efficiency through the production of standardized ships using production-line techniques. It is evident in Table 7-1 that although France's shipbuilding industry is in decline, as is the world-wide shipbuilding industry, it has managed to remain relatively competitive.

Adjustment problems in the shipbuilding industry can be related to a number of factors. One is the interdependence of shipping and shipbuilding. Any decline in the volume of world trade will create excess shipping capacity and a fall in freight rates and shipping earnings, thus reducing the demand for new ships. Changes in the composition of world cargoes also cause adjustment problems. Demand for specialized ships, for instance, has increased to meet the specific needs of growing industries, such as natural gas and chemicals. Changes in supply conditions, which have exacerbated problems of adjustment, include the switch in competitive advantage to low labour-cost nations such as Brazil, South Korea and Taiwan. Since the industry is labour intensive, these nations have strong cost advantages.

GOVERNMENT INTERVENTION

Shipbuilding in France is an important industry in terms of export earnings. It also has a significant employment effect in the coastal regions and a significant upstream effect on steel production. For similar reasons Japan has pushed adjustment in the industry by developing greenfield sites in coastal areas with integrated steel-making facilities to lower the cost of steel inputs. Japan also led the way in initiating state-backed export credits and financial support for builders during construction. France was quick to follow this lead, in an effort to secure the French industry a competitive position within the world market. During

TABLE 7-1 Shipbuilding Completions

	1950	1960	1970	1975	1976	1977	1978	1979	1980	1981
France	174	174	859	1,150	1,673	1,107	440	720	283	502
World share (%)	5.3	2.1	3.9	3.1	4.9	4.0	2.4	5.0	2.2	3.0
United States	393	379	375	476	815	1,012	1,033	1,352	555	360
Japan	232	1,839	10,100	16,991	15,868	11,708	6,307	4,697	6,094	8,400
United Kingdom	1,398	1,298	1,327	1,170	1,500	1,020	1,133	691	427	213
West Germany	81	1,124	1,317	2,499	1,874	1,595	845	437	376	703

Source: Peter Mottershead, "Shipbuilding: Adjustment-Led Intervention or Intervention-Led Adjustment," in *Europe's Industries: Public and Private Strategies for Change*, edited by Geoffrey Shepherd, François Duchêne, and Christopher Saunders (London: Frances Pinter, 1983, p. 83).

the period of reconstruction marked by the First National Plan, the French government initiated a program of assistance to shipyards to decrease the financing costs of ship production through government-provided or -guaranteed credit. Until 1966, this subsidy stood at 15 percent of the selling price of a ship (Mottershead, 1983, p. 84). In 1960, the French government, following the theme of the National Plans, initiated a plan to reduce the number of shipyards from 14 to 4 (United States, 1979, p. 66). The remaining yards were to be modernized, and employment was to be reduced from 40,000 to 27,000 workers. Displaced workers were to be re-employed by converting areas of a number of shipyards to the production of other goods. From 1965 to 1970, the annual average level of assistance to the industry was 200 million francs (*ibid.*, p. 68). During the 1960s, French policy was successful in modernizing and concentrating the industry. Production increased by 60 percent from 1960 to 1969, employment fell by 34 percent, productivity doubled, and France rose from the sixth-ranked shipbuilding nation to the fourth. In 1969, the French industry held 100 percent of the world market for large gas tankers (*ibid.*, p. 68).

In the period before the oil crisis of 1973, reorganization was envisaged within a world context of trade expansion, notably in the energy field; it involved technical reorientation, particularly the construction of large tankers and specialized vessels (OECD, 1978, p. 94). Since the energy crisis conditions have changed, France has, of necessity, become less optimistic about industry prospects, because of world excess capacity in oil transport, and has focussed on specialization and the reduction of capacity. Nonetheless, subsidies to French shipyards continued throughout the 1970s.

In the 1970s, France decreased the use of construction subsidies and increasingly employed an inflation-insurance program. Under the program, insurance is provided against inflation in shipbuilding costs which exceed a certain threshold. The threshold was set at 5.4 percent in 1971, 7.4 percent in 1973, 13.6 percent in 1974, 11.7 percent in 1975, 9.7 percent in 1976, and 7.3 percent in 1977. The program, administered by the Ministry of Transport, allowed shipyards to remain competitive and to attract orders by enabling them to quote fixed-price contracts, since much of the inflation risk was absorbed by the government. The value of the program declined as inflation fell. From 1970 to 1975, however, program expenditures were estimated at 20 percent of the value of deliveries (United States, 1977b, p. 11), making it the most costly assistance program directed at shipyards.

Since the 1971 OECD Understanding on Export Credit for Ships, export credits to enable yards to offer credit to foreign customers on favourable terms have been provided by private banks, with the support of government institutions such as the *Crédit national*. Prior to 1970, the French Foreign Trade Bank provided export credits. Pursuant to the

TABLE 7-2 Expenditures on Assistance Programs to Shipyards, 1970-75

	1970	1971	1972	1973	1974	1975
	(US\$ million)					
Total appropriated	63.9	94.5	119.9	164.7	163.3	186.6
Construction subsidies	40.6	35.9	33.1	30.3	28.0	25.7
Inflation insurance	20.1	46.9	76.5	114.8	148.1	178.5
Export credit	35.0	35.0	35.0	35.0	35.0	35.0
Total expenditures	60.7	82.8	109.7	146.1	176.1	199.5

Source: United States, Department of Commerce, Maritime Administration, *The Maritime Aids of Six Major Maritime Nations* (Washington, D.C.: U.S. Government Printing Office, 1977), p. 39.

OECD Agreement, as of July 1, 1974, credits must have a maximum term of 7 years; recipients of credit must make a minimum downpayment of 30 percent, and lenders must charge a minimum interest rate of 8 percent, including fees. All export credits of more than two years' duration must be insured by the Compagnie française d'assurance pour le commerce extérieur (COFACE), a government agency. The value of exports to the French shipbuilding industry was estimated conservatively at \$US 300 to 400 million per year from 1970 to 1975. With 80 percent government financing and a 2 percent interest differential between market loans and government loans, the benefit of the export-credit program is estimated at \$US 35 million per year, as Table 7-2 indicates.

The French government has also used a program of direct construction subsidies for vessels built in French shipyards, whether for domestic owners or for export. The subsidy is a lump-sum grant based on a percentage of the contract price of a ship. Its original purpose was to equalize the costs of French-built and foreign-built vessels. During the early 1960s, the subsidy was at a peak of 21 percent of the contracted price. This subsidy declined to 10 percent in 1968, 4.9 percent in 1970, 0.5 percent in 1974, and was eliminated in 1976 in the spirit of the 1972 OECD General Arrangement negotiated between EC nations and Japan. The arrangement was intended to lead to a balanced reduction in aids to shipbuilding to be negotiated through the OECD Working Party. Until 1975, nations party to the General Arrangement acted in its spirit; after that date governments showed an increasing tendency to invoke Clause 7, which allowed aid in particular cases for "unforeseen and imperative reasons." On December 15, 1976, the French cabinet approved a 10 percent export-building subsidy to small yards as an anti-recession aid. A domestic construction subsidy of 15 percent was also approved. Since 1977, grants to French shipyards have ranged between 15 to 25 percent of contracted price, depending on the size of the yard and the type of vessel built. In addition to the grants made, ceilings are imposed on orders for individual yards, pursuant to a program to cut capacity. Currently,

TABLE 7-3 French Share of World Deliveries

	Deliveries from French Shipyards in Dead-Weight Tons (millions)	French Shipyards' Share of World Output (percent)
1970	1.36	3.9
1971	1.83	4.6
1972	1.62	3.7
1973	2.04	3.9
1974	1.98	3.3
1975	1.86	3.1

Source: United States, Department of Commerce, Maritime Administration, *The Maritime Aids of Six Major Maritime Nations* (Washington, D.C.: U.S. Government Printing Office, 1977), p. 44.

signatories to the OECD Arrangement have decided that there can be only limited progress in the reduction of aids until the market improves.

French policy has been directed at adjusting to decline by cutting capacity in the shipbuilding industry, through programs to encourage the conversion of shipyards to other activities and through the retraining of employees. The object is to streamline the industry into a smaller number of highly efficient yards without causing massive layoffs. Under a sectoral plan of July 1977, the government appropriated one billion francs over five years for a program under which all shipyards would regroup into two companies, Alsthom Atlantique and Chantiers de France Dunkerque.

IMPACT OF INTERVENTION

The majority of policy instruments employed by the French government toward the shipbuilding industry, such as inflation insurance, export credit and direct subsidies, have retarded adjustment by artificially increasing the competitiveness of French-built ships without realizing major structural changes or major reductions in employment, directed at releasing resources from a declining industry. During the early 1970s, when the shipbuilding industry was in crisis, French output did not decline appreciably. Since world shipbuilding output was growing, however, the French shipyards' share of world output declined, but rebounded in the latter half of the 1970s, to decline again in 1980, as indicated in Table 7-3.

The French shipbuilding industry became increasingly specialized during the 1970s, shifting resources into more dynamic areas of the sector, to capture new demand. This greater specialization enabled the industry to increase its world-market share. Concentration in building has been on container ships and liquefied gas carriers. As a result of the specialization, shipyards became more dependent on export orders, since these vessels do not correspond with the composition of the

French shipping fleet. It is this interdependence between the shipping and shipbuilding industries which accounts for the absence of policy instruments aimed at import protection to assist shipyards. Because ships are capital goods and shipbuilding is an internationally mobile industry, to protect domestic shipbuilders through quotas or tariffs would penalize domestic shippers, since they would not have access to the least expensive ships, and their freight costs would not be competitive (Mottershead, 1983, p. 93).

The Textile Industry

BACKGROUND

Textiles received a minimum of government assistance in the period of reconstruction following World War II. The industry failed to modernize, and it was not until the 1970s that large firms emerged to take the place of small, family-owned firms. During the 1950s, the industry was inefficient and non-competitive, and thus it was severely affected by the closure of the Indochina market to French textiles, which occurred when French forces pulled out of the Indochinese War. The profit squeeze resulted in inadequate investment, since retained earnings had been the major means of financing investment. In an effort to recover, the industry redirected itself toward France's African colonies, where the market was protected. Membership in the EC, in 1957, exposed the industry to competition, which was increased following decolonization in Africa. Unemployment and bankruptcies threatened the textile industry early in the 1960s. At this time the government began to lend support to a program of concentration, using measures such as the tax incentives outlined earlier in the Act of 1965. From 1963 to 1969, the number of textile firms fell from 7,439 to 4,763, and employment began to decline (Mytelka, 1982, p. 135). Concentration resulted in the creation of an unhealthy dualism in the industry as the government encouraged mergers while keeping small firms alive by means of protection and employment support (Shepherd, 1983).

The crisis deepened in the 1970s, when competition increased from developing countries, the United States and Italy, worldwide demand fell, and import penetration increased. In 1973, import penetration in the spinning and weaving sectors stood at 45 percent of the domestic market; by 1979, the level reached 72 percent (Mytelka, 1982, p. 137). At that time a turning point was reached in the industry. Large firms were required to reach a decision: Would they continue to ally politically with small firms and their demand for protectionism, and thus maintain the traditional structure of the industry? Or would they identify themselves with other dynamic sectors and pursue modernization and specialization, stressing exports? Within the industry the number of small firms

had declined, and those that remained employed fewer people, with the consequence that their contribution to total sector turnover declined. In 1970, the top 12 firms contributed 21.7 percent to sector turnover, while the bottom 2,440 contributed only 16.7 percent (Mahon and Mytelka, 1983, p. 572). The textile industry as a whole was also losing its political importance as the percentage of the labour force in textiles dropped from 14.6 percent of the total labour force in manufacturing in 1956 (an extremely high percentage compared to that of most other industrialized countries at this time) to 4.9 percent in 1977 (Mytelka, 1982, p. 140). The growth of new industries also meant that whereas, in 1956, 4.7 percent of all industrial firms were producing textiles, by 1977 that figure was 2 percent (*ibid.*).

The struggle between the large and small textile firms continued as large firms established subsidiaries in African nations to jump the tariff walls which small firms faced. Small firms remained in operation by running down machinery, making no allowances for depreciation, and undertaking no reinvestment. Large firms under pressure appealed for government assistance to modernize and used the assistance provided to specialize in high value-added products at the upper end of the market. The emphasis was no longer simply on concentration to create larger, more efficient conglomerates, but on modernization within the large conglomerates. From 1969 to 1978, the number of plants within spinning and weaving firms declined from 518 to 380, indicating extensive rationalization (Mahon and Mytelka, 1983, p. 576). The development of the textile industry in the 1970s led to a blurring of the line between "traditional" and "dynamic" industries (*ibid.*). Large French textile firms, which now dominate the industry, use modern production processes that include the incorporation of electronic devices into machinery to test textile quality and the computerization of elements of the design process. Although adjustment was largely industry initiated, government policy has assisted adjustment within the textile industry, and this policy has resulted in a more dynamic sector with reduced employment, and larger, more modern firms. But compared, for example, to West Germany and Italy, the French textile industry still lags in productivity; smaller firms continue to resist state assistance in order to preserve their independence, but lack the capital to modernize.

GOVERNMENT INTERVENTION

In 1954, when a number of textile firms were failing and others were unable to adjust to the loss of the Indochina market, the *Syndicat général de l'industrie cotonnière* (SGIC) — the Cotton Textile Industry Association — appealed to the state. With the Ministry of Industry and the Planning Commission, the SGIC prepared a five-year program for the reorientation of the cotton-textile industry away from Indochina to the

protected markets of France's African colonies. Assistance was needed to allow firms to scrap narrow looms and purchase wider looms to weave the *pagnes* which were the bulk of the African cotton textile trade. Since the SGIC was dominated by small family-owned firms, most of the aid went to protect and preserve the industry's small-scale operations, in contravention of the state's larger policy of encouraging concentration. During the 1950s, the industry was also protected from pressure to modernize by France's neo-mercantilist policy of growing cotton in the colonies to ensure a cheap supply of raw material and using the colonies to ensure a market for textile exports from France.

The cotton industry became exposed to international competition with the 1957 ratification of the Treaty of Rome and the formation of the EC, which renewed interest in concentration of the industry. In 1965 and 1967, subsidized credit to encourage mergers was made available through the Fonds de développement économique et social (FDES), and in July 1965, tax laws were modified to assist large firms by means of tax incentives. At this time large conglomerates, such as the Boussac and Agache-Willot textile empires, came into being. The industry was assisted further through protectionist measures. In 1962, the majority of textile-producing nations negotiated, under GATT, the Long-Term Arrangement for Cotton Textiles (LTA). The LTA served to limit cotton-textile imports. However, competition from Asian and South European producers increased, and then, following decolonization, Africa closed its market. Unemployment and bankruptcies threatened.

The French policy response was to retard adjustment. A system of payments to workers on short hours allowed small marginal firms to survive through subsidizing labour costs. Labour remained within the declining industry as workers went on short hours at reduced pay rather than retrain. While economic conditions encouraged mobility out of the industry, this response was countervailed by policy. Decline in the industry continued as only a few small firms applied for tax credits, and for subsidized loans and grants made generally available for mergers in the 1950s and 1960s. As competition between small and large firms in the industry continued, putting downward pressure on profits, the Precheur Report was tabled, in 1965, by Jean Precheur of the Conseil économique et social (Mytelka, 1982, p. 136). The report recommended an increase in the number of mergers and takeovers, the elimination of marginal firms, and the creation of a textile fund to undertake these restructuring activities. In 1966, the Union des Industries textiles (UIT) and the state created a fund: the Centre inter-professionnel de rénovations des structures industrielles et commerciales de l'industrie textile (CIRIT). Labour representatives were excluded from the CIRIT, since labour had been marginalized from political decision making in France's centre-right coalition government. Control lay in the hands of large firms and the state. Funds were granted to large firms for the purposes of mergers and

acquisitions, while they were withheld from small firms willing to modernize within existing structures and scales of production, but unwilling to merge. The result was limited real rationalization as protection of the domestic market reduced incentives to modernize within the large firms, while the small firms lacked adequate investment capital.

Throughout the 1960s, French exports remained high, and the franc zone remained important because of protectionist policies. From 1965 to 1969, 86.5 percent of all cotton and synthetic cloth exports were directed at the franc zone (Mytelka, 1982, p. 136). Although the French balance of trade in textiles remained positive until 1975, the rate of import penetration increased dramatically following the 1973 Multi-fibre Arrangement (MFA) which liberalized textile trade with developing countries (*ibid.*, p. 137). The pressures of international competition were aggravated by the recession of the mid-1970s, which precipitated another crisis in the textile industry. From 1970 to 1979, the number of firms with 6 to 49 employees dropped by 42.2 percent, firms with 50 to 99 employees by 24.1 percent, firms with 100 to 199 employees by 17.2 percent, firms with 200 to 499 employees by 18 percent, and firms with over 500 employees by 42.7 percent as these firms were forced into major rationalization efforts (*ibid.*, p. 139). The number of unemployed persons in the textile industry increased from a 1958–74 annual average of 15,347 to 35,195 in 1977 (Mahon and Mytelka, 1983, p. 574). The number of firms in the industry declined from 3,704 in 1970 to 2,568 in 1979, while over the same period, employment fell from 418,758 workers to 294,483 workers, a decline of 29.7 percent (Mytelka, 1982, p. 139).

Protectionist policy was reinforced when the EC Commission invoked safeguard clauses in the MFA in July 1975, and subsequently a more restrictive MFA was negotiated for 1977–81. However, international economic pressures and domestic social changes, such as the decline in the proportion of the total labour force employed in textiles, created pressures for a new textile policy. As the number and strength of large firms in the industry increased, the state began to use these firms as partners in a restructuring process. The Comité interministériel pour l'aménagement des structures industrielles (CIASI), established in 1974, became the principal state instrument influencing adjustment in the textile industry (Mytelka, 1982, p. 141). The policy objective changed from one of protection and the retardation of adjustment to pushing adjustment through modernization. CIASI's function was to encourage private and state banks to support restructuring in a collaborative effort between the state and UIT. From 1975 to 1978, over 50 percent of the agency's loans went to the textile industry (Table 7–4). Financing was heavily biased toward large firms which would enter a contract with the CIASI in the spirit of the *économie concertée* feature of policy making. CIASI would work directly with the firm without input from UIT or SGIC, the textile-labour and -industry associations. From 1976 to 1978, one-third of all

TABLE 7-4 CIASI Loans to Textile Industry

	1975	1976	1977	1978
Number of recipient textile firms	53	54	42	35
Loans to textile firms (FF million)	268.9	76.4	62.2	181.2
Total amount of loans granted (FF million)	394.6	210.1	108.5	343.6
Percent to textile firms	68.1	36.4	57.3	53.0

Source: L.K. Mytelka, "In Search of a Partner: The State and the Textile Industry in France," in *France in the Troubled World Economy*, edited by Stephen Cohen and Peter A. Gourevitch (London: Butterworth, 1982), p. 141.

CIASI-aided cases involved takeovers, and this trend placed pressure on small firms. In 1976, although only 7 percent of the firms to receive aid had turnovers of more than 100 million francs, these firms received 35 percent of all loans. By 1978, 21 percent of the firms assisted received 95 percent of the funds allocated (Mytelka, 1982, p. 142). In 1979, the emphasis of the program shifted from takeovers toward internal rationalization and modernization. Grants are now provided only to firms willing to increase productivity and to specialize in technologically advanced textile products. Those firms are favoured which already have concentrated production. CIRIT was reoriented to cover up to 30 percent of new investment costs without the precondition of expanding the scale of production.

New policy instruments directed at the textile industry are designed to orient investment to technologically advanced, capital-intensive processes. The *prêts participatifs*, 20-year loans made available by the Ministry of Industry and repayable only when a firm becomes profitable, are available to textile firms. In 1979, however, only four textile and clothing projects were subsidized. Textile firms may also enter into a *contrat de développement* between a firm and the Ministry of Industry. The firm commits itself to develop a product and to increase the turnover of exports during a given period. Financial aid granted is not linked to job creation. In 1981, the textile industry was included among the six strategic industries to fall under a program directed by CODIS, the Inter-ministerial Committee for the Development of Strategic Industries.

Policy instruments in France recently directed at the textile industry have resisted the pressure for protection of the industry exhibited by most industrialized nations and by France itself until the mid-1970s. The French state has responded to demands from the industry for assistance to modernize and has reinforced the dominance of large firms within the industry. Still, France continues to use a mix of adjustment-promoting

and defensive policies. At the EC level, France has led the move to limit outward processing: that is, subcontracting a portion of the manufacturing process to cheap-labour nations and reimporting the product. This would cut the West German advantage in cost reductions through outward processing, a tactic which the West German industry, in particular, used as a cost-saving device, and would ensure sufficient protection of the European market to enable French producers to continue modernization (Mytelka, 1982, p. 144).

THE POLICY-MAKING PROCESS

During the 1950s and 1960s, the state was only marginally involved with the textile industry; state involvement included maintaining employment and protecting African markets. The concentration which was encouraged, and which occurred within the industry in the 1960s brought about a dualism within the industry that precipitated a change in policy in the 1970s. Early in that decade, the alliance between the large and small firms in the industry continued, and the industry's labour and trade associations renewed pressure for protection of the domestic market. With the adoption of the restrictive MFA of 1977, concentration and protection remained policy objectives. This state of affairs reflected the political importance of the small textile firms, *les petites et moyennes entreprises*, which were one of the important constituencies of the centre-right coalitions that dominated French politics from 1958 to 1981. Protecting the textile industry also enabled that industry to retain its labour-absorbing character, which was an important hedge against labour militancy. This was a particularly important consideration in 1978, when the government faced a united left in the elections.

By the mid- to late 1970s, however, it was evident that a small number of large firms had gained privileged access to policy making. These firms pressed the state for assistance directed at modernization, and in the ensuing years they created a dynamic sector within a traditional industry. Labour unions, which are weak in the textile industry, have had minimal input into the restructuring process.

IMPACT OF INTERVENTION

Following the pattern in the steel and shipbuilding industries, the textile industry has become increasingly concentrated. Specialization in higher value-added products has increased, and the industry has modernized extensively. Production and employment have declined as resources have moved out of the industry (Table 7-5). The firms which remain are larger and incorporate more efficient production processes, which are capital intensive rather than labour intensive. Yet France's net trade

TABLE 7-5 Production and Employment in French Textiles

	1963	1973	1975	1978	1979	1980	1981
Index of production (1973 = 100)	85	100	89	90	93	89	81
Employment (1000s)	459	406	371	329	318	307	285
Index of labour productivity (1973 = 100)	74	100	96	110	117	117	114

Source: Geoffrey Shepherd, "Textiles: New Ways of Surviving in an Old Industry," in *Europe's Industries: Public and Private Strategies for Change*, edited by Geoffrey Shepherd, François Duchêne and Christopher Saunders (London: Frances Pinter, 1983), p. 30.

balance in textiles has been negative since 1975, a fact which indicates that further rationalization is called for.

Conclusions

The French policy approach to declining industrial sectors has emphasized industrial restructuring through consolidation and concentration of firms, and modernization. Where contraction has occurred, labour has borne a large share of the costs and has, on occasion, protested the path of industrial development. Provisions for workers made redundant are largely compensatory, and no attempt is made to tie benefits to retraining. In future, Mitterrand, whose Socialist party is more ideologically sympathetic to the transition costs faced by labour, may be more sympathetic to policies that cushion the burden.

Government control over the financial system, and the close relations between business and political élites have permitted the state to guide explicitly the pace of industrial changes. The primary motivation of French policy makers has been the desire to develop internationally competitive French industries. To achieve this goal, particularly in the steel, shipbuilding and textile industries, French policy makers relied on pragmatic policy tools. In these three industries the emphasis was on the creation of large firms which could capture economies of scale. The potentially detrimental effects of monopoly on domestic competition have not been a major concern. France has weak antitrust legislation, and the Monopolies Commission rarely uses such powers as it has. Initially, concentration was carried out with limited concern for international rationalization such as the closure of inefficient plants and the release of labour. Coinciding with the Barre administration, however, and with its emphasis on strengthening the market, there has been a policy shift from a largely defensive to an offensive orientation. Perhaps

surprisingly, Mitterrand's administration has approved the emphasis on adjustment rather than on its retardation at the instance of established socio-political interests such as labour and small business. Massive redundancies in the steel industry and the closure of plants have coincided with a push toward specialization. Shipbuilding has become more competitive through specialization, although the French policy approach has involved heavy subsidization. France's textile industry has made substantial adjustments. Following a period of protectionism, when industrial policy was heavily influenced by the interests of small marginal firms, large firms established by mergers began to dominate the industry and to use modern production processes to turn out high value-added products. Adjustment in the textile sector was largely industry initiated, although government has provided substantial assistance to ease adjustment in the textile industry for large firms. France's textile industry is now increasingly capital intensive, and some of its segments are internationally competitive.

The French state played an active role in the development of the steel, shipbuilding and textile industries reviewed in this chapter. Intervention occurred to prompt (and often to underwrite) industrial restructuring, to accelerate rationalization, and to create "national champions" capable of meeting international competition. Assistance to declining industries has been offered both at the level of the firm and at that of the sector. A policy mix of ad hoc and programmatic approaches characterizes the French approach to industrial development.



The West German Policy Approach to Declining Industrial Sectors

The Policy-Making Process

West German industrial policy has emphasized efficient structural adjustment involving minimal assistance to declining sectors and a reliance on market forces to allocate most productive resources. Policies are aimed at the longer-term competitive position of the industry target. The state's role is to maintain stability as a precondition to the effective functioning of the market. Thus West German governments generally have not favoured intervention to assist specific declining industries; instead, they have channelled assistance through established employment, social insurance and regional development programs. The formalization and openness of the economic policy-making process, which grants a role to the Council of Economic Experts, independent economic research institutes, and industry and labour organizations, may serve to shield government from sectional interests by encouraging consensual policy making:

Economic problem solving [has taken] a technically rational character. It [has been] pervaded by a functional rather than an ideological spirit that [has] subordinated specific goals to the larger requirement of an effective functioning of the whole economy. (Dyson, 1981, p. 53)

Government Organization and Bureaucracy

West Germany's federal structure, rather than providing more points of entry for interest groups seeking to influence the policy-making process, as in the United States and Canada, appears to have resulted in weaker pressure on the federal Parliament for selective interventions. *Lander*

(state) campaigns are often waged on national issues, since the voice of the state government at the federal level is the *Bundesrat*, the upper chamber, which approves all federal legislation that directly affects the states. Thus, state governments are encouraged to take positions on many national issues, and this policy reduces the provincialism which might otherwise characterize state politics (Goldman, 1974, p. 75). Federal policy has discouraged regional priorities. Nevertheless, the state administrations play an important role in the implementation of programs, and it is at the state level that the larger part of West German bureaucracy is to be found. "Functional federalism" thus characterizes West German government organization, which assigns primary responsibility for policy making to the federal government and that for administering and implementing policy to the *Länder* governments. A functional federation contrasts with "jurisdictional federations" such as Canada, where policy responsibilities are more evenly shared by the federal and provincial governments. In Germany, therefore, interest groups have a strong incentive to direct most of their organizational efforts at the national level.

Although West Germany, unlike Japan and France, has no specific industrial ministry, its bureaucrats influence the policy-making process both in the bureaucracy and in the political arena. The most influential bureaucrats, most of whom have had post-secondary school training in law or economics, bring a rationalistic style to policy formation. They perpetuate the *Reichstaat* ideology that exalts the role of bureaucracy as superior to the particular divisions of politics, although the bureaucratic and political spheres largely overlap in West Germany. Many party office holders are *Beamte* (tenured public servants), and many *Beamte* leave their posts to run for political office. The proportion of *Beamte* and other public officials in the *Bundestag* has grown continuously, from 16.8 percent in 1949–53 to 41.9 percent in 1976–80 (Dyson, 1982, p. 23; Von Loewenstern, 1985, p. 31). Moreover, many *Beamte* sit on parliamentary committees:

This political presence of the *Beamte* in ministerial organization, in parliamentary committees and in party committees reinforces the strength of technical values of *Sachlichkeit*, particularly legal values, and an expert attention to detail in the policy process. (Dyson, 1982, p. 23)

In addition, substantial cross-fertilization occurs between the *Beamte* and executives of trade associations and trade unions through lateral appointments and other measures.

The "Universal" Banking System

West German banks play a major role in assisting industrial adaptation. Banks must approve government assistance to industry, and usually

must make a substantial commitment of their own funds to assistance projects (Medley, 1982). The interdependent relationship between the banks and industry is enhanced by the presence of bank representatives on the supervisory boards of major corporations, and by extensive bank shareholdings in business. In addition, almost 85 percent of all shareholders in West Germany deposit their shares with one of the "big three" banks: Deutsche, Dresdner, or Commerzbank, under trust agreements which provide the bank with broad discretion to vote by proxy (ibid.). Under West German company law, the votes of 25 percent of the shares in a company are sufficient to block any measure submitted for shareholder ratification, which is generally required for major business decisions (ibid.).

As of 1980, the banks controlled 70 percent of the shares of the 425 largest firms in West Germany (Hall, 1982). This situation guarantees the banks a strong role in crisis management. The banks have served as an "early warning" system which has identified weaknesses in industry and acted pre-emptively to resolve problems. Their role in assisting the restructuring of a failing industry or firm is made easier because banks do not face the same political pressure to protect employment or to meet the interests of pressure groups that governments face (Dyson, 1981, p. 50).

The Role of Labour Organizations

In 1978, exports accounted for 27 percent of gross national product (GNP) in West Germany, with the result that the country's economy is highly vulnerable to changes in the international economy (Dyson, 1981, p. 36); both Japan and the United States have relatively more closed economies and are thus less vulnerable than is West Germany. Exports accounted for 12 percent of Japan's GNP in 1978, and 6 percent of GNP in the United States. This vulnerability has resulted in an export-oriented modernization policy, which has been supported by trade unions, despite heavy social costs. The condition for support has been co-determination or corporatist democracy at the firm, sectoral and national levels. Co-determination operates under a two-tier system within which employees have representatives at the plant level, in Works Councils, and on the supervisory boards of any joint-stock or limited-liability company with a specified minimum number of permanent employees; the number depends on company size. Employee representatives also sit on the management board.

Labour is organized along industry lines into 16 large unions, some with several million members, although only 30 percent of the work force is unionized. All unions are affiliated to the central body, the *Deutsche Gewerkschaftsbund* (DGB), which is directed by leaders of the member unions. The DGB is able to adopt a broad perspective on the costs and benefits of alternative economic policies and to facilitate

consensus among the unions. While it represents labour in the national political process, the Works Councils negotiate plant-level agreements with employers. West German labour law requires the formulation of detailed "social plans" which comprise all the issues that must be negotiated between management and Works Councils in advance of permanent staff reductions or shutdowns (Trebilcock et al., forthcoming). The law also obliges the employer "to make every reasonable effort" to avoid dismissal, perhaps by redistributing work or by transferring employees to other jobs (Seyforth et al., 1969, p. 463). A result of this consultative process has been that, at least until recently, rationalizations, mergers and shutdowns generally have not been prevented or blocked by labour representatives, despite their negative social effects.¹ Labour has participated in a formal process whereby workers can ensure that they will be compensated for the transition costs of adjustment through severance payments, retraining and relocation programs.

On the national level, labour is represented in economic policy making by the DGB, which has had extensive links with the Social Democratic Party and important, if less visible, links with the Christian Democrats. The officers of the DGB's 16 federations have generally provided SPD leaders. In 1972, 10 of then Chancellor Brandt's 15 SPD ministers had been recruited through the DGB (Joseph, 1979, p. 79). The DGB also has close ties with industry and has adopted a business-like style of management within its own organization. It owns the *Bank für Gemeinwirtschaft*, the fourth-largest bank in Germany, as well as housing units, a shipping fleet and over 6,000 cooperative retail stores (Goldman, 1974, p. 137). The earnings from these interests have helped to fund effective lobbying efforts on matters of interest to labour, and have enabled the DGB to maintain a substantial staff of labour lawyers and other specialists.

The Role of Business Organizations

Business, too, is represented in the political process by strong federal organizations which influence economic policy. The *Deutscher Industrie und Handelstag* (DIHT) is the federation of trade and employers' associations. Its membership includes 80 percent of all private companies and 90 percent of employers. The constituent organizations of the DIHT are themselves often highly inclusive, well-integrated, peak organizations representing large sectors of the economy. In what some analysts have termed a secret and exclusive process (Kuster, 1974), representatives from the DIHT, the DGB, the Council of Economic Experts, executives of banks and cabinet ministers (particularly the minister of finance) meet regularly to consult on major economic issues. While this process has improved the consistency and coherence of industrial policy, it is also an extra-parliamentary executive-oriented process which, to a number of analysts, appears anti-democratic.

Within the West German political system, the federal and state governments, and labour and business organizations have important roles. The system operates on a consensual basis, since no action may occur without the agreement of these power brokers. The usual result of the policy-making process is policy which resists assistance to particular interests, such as declining industries. This result is often seen as evidence that an inclusive process which grants major interest groups a voice in decision making will instigate policies aimed at enhancing national wealth or speeding structural adjustment, rather than the redistribution of wealth in favour of particular industries.

Constraints Imposed by Membership in the European Community

Although the general pattern in West German industrial policy has been to resist specific assistance to declining industries, the government has sometimes acted to assist industries in difficulty; one such instance is the bail-out of Telefunken. Such actions are limited by Articles 92 and 94 of the Treaty of Rome (1957), which prohibit government aid that interferes with free trade. The West German government must submit proposed measures for assistance to the European Commission in Brussels. If these measures are approved under a number of escape clauses, the government may proceed to provide assistance.

Autonomy in industrial policy making has also been restricted by Germany's membership in the European Coal and Steel Community (ECSC). This body, now administered by the Commission of the European Community (EC), has the power to impose minimum prices or quota assignments on firms in order to stabilize coal, iron and steel markets. West Germany has often disagreed with the imposition of quotas and other trade restrictions, but has accepted them as a condition of ECSC membership.

General Programs

Programs Directed at Labour

Assistance to labour which has been affected by the transition costs of industrial adjustment is provided through general programs, rather than through the establishment of special assistance. Income maintenance is provided under the national unemployment-insurance scheme, geographical mobility is addressed through relocation subsidies, and occupational mobility is furthered through vocational training and retraining programs.

The unemployment-benefit program is funded by legislated contributions from employers and employees. It is administered by the Federal

Employment Institute, which was established in 1952 as a central agency for labour programs. The Institute is financed both by voluntary contributions from employers and employees and by an additional contribution from all workers of 1.5 percent of their salaries. It is subject to supervision by the Ministry of Labour, but is self-governing through representatives from trade unions, employer associations and public organizations.

Unemployment benefits comprise 68 percent of net pay earned during the last 20 days before unemployment. (This stipulation may act as a disincentive to employees to take a wage cut when a firm is in trouble, since it may result in reduced benefits in the event of subsequent layoffs.) Depending on the duration of a worker's employment over the preceding three years, he or she is entitled to between 78 and 312 workdays of benefits. A beneficiary may be disqualified for refusal to relocate or to participate in a retraining program. Once unemployment benefits expire, workers are assisted under the unemployment-assistance program which provides benefits of unlimited duration. This program is funded by the federal government, but administered by the Federal Employment Institute. Benefits amount to 58 percent of the recipient's earning level in her/his last place of employment.

West German employment policy places emphasis on vocational training and on incentives to geographical and occupational mobility. Attempts are made to match training and placement efforts with the specific sectors of the West German economy that offer expanding job opportunities. The Federal Employment Institute is required by law to conduct a comprehensive labour-market and occupational research program. The results of this research are used to develop training programs and apprenticeships, to assist the placement of unemployed workers, and to analyze the needs of the labour market. Under the *Employment Act* of 1971, both individuals and training institutes are eligible for assistance in acquiring or providing training. Maintenance grants of 80 percent of previous wages cover all or part of the costs of tuition, educational supplies, travel, accident and sickness benefits, and lodging if trainees are away from home. They are paid to unemployed individuals seeking retraining in Institute programs. Institutions receive grants or loans to establish training and retraining centres. If necessary, an institute may establish its own centres. Institute statistics indicate that two-thirds to three-quarters of those who received training from 1970 to 1975 obtained better jobs or were using their new skills (United States, 1979, p. 156). In 1975, 270,853 employees were participating in state-supported training programs (OECD, 1978, p. 120).

A job-creation program was established in 1975, to provide wage subsidies to firms as an incentive to create new jobs which would not otherwise be available. The Federal Employment Institute provides a subsidy based on the hourly wage paid to an employee who is assigned

by the employment office to a position for which he or she is eligible. The Institute may provide subsidies amounting to 120 percent of the wage, depending on the skills required. Subsidies are higher if the job created requires skills that are in excess supply on the labour market.

The Short-Time Allowance program was created to reduce the number of workers being laid off for short periods because of temporary business downturns. An applicant must have had a work-week decrease of at least 10 percent for four consecutive weeks, and at least one-third of the firm's employees must be affected. The Federal Employment Institute subsidizes a pay reduction with short-term allowances which are granted for a specific period which is not to exceed six months. The employer and the employee must both apply. The amount to be paid is determined by the employer, who is then reimbursed by the Institute. The employee is guaranteed 68 percent of net pay while in the program and working short time. In 1975, 750,00 workers received short-time allowances, at a total cost of slightly more than DM 3,000 per recipient (United States, 1979, p. 154). Institute statistics indicate that the program prevented unemployment for 170,000 workers (*ibid.*), who were able to remain partly employed because of the short-time allowance.

As part of the Short-Time Allowance program the Institute operates a transitional voucher program.² The latter program provides a subsidy to workers who are unemployed because of a plant shutdown. Workers negotiate with their new employer for a wage package which approximates the earnings received at their last place of employment. The employer receives a subsidy for the difference between the audited cost of hiring and retraining the worker and the audited contribution of the worker to profits. Works Councils have authority to ensure that subsidized workers are not dismissed once the subsidy program ends.

In December 1974, the Program to Promote Employment and Growth in Conditions of Stability provided for a non-recurring mobility grant to be paid to workers who had been unemployed for an extended period of time, to make it easier for them to accept employment elsewhere. A moving incentive was granted of DM 1,000 in cash, plus reimbursement for costs up to DM 4,000 (plus DM 800 for dependants). A worker who changed residence for new employment was eligible if the new job was at least 30 kilometres from the prior work location. Under some circumstances the costs of applying for a job and travelling to an interview could be reimbursed. Subsidies and loans cover the cost of tools and transitional allowances for living expenses until the first wages are paid. From November 1976 to May 1977, 23,000 workers were paid DM 23 million in relocation premiums (United States, 1979, p. 20).

West German employment policy is aimed at promoting the movement of labour out of declining sectors and into dynamic areas of the economy. The Short-Time Allowance is the only program which might be considered as retarding adjustment by keeping workers in jobs they might

otherwise leave. The program is justified, however, on the ground that it prevents layoffs where long-term employment is viable. The system often amounts to temporary work sharing; rather than permitting layoffs of some workers, who would receive only unemployment benefits, it prevents layoffs by reducing hours for all employees and paying benefits for hours not worked.

Programs Directed at Industry Assistance

REGIONAL DEVELOPMENT POLICIES

Forty-nine percent of the aid granted to industries in West Germany is channelled through regional development programs which are financed equally by the federal and state governments (Glissman and Weiss, 1980, p. 16). Over the past decade the average annual budget for regional programs has been \$4 billion (in 1980 U.S. dollars) or 15 percent of total West German industrial investment during this period (Magaziner and Reich, 1983, p. 272). Assistance is distributed to regions, and not to specific industries; special emphasis is placed on the Ruhr, the Eastern Border Zone, and West Berlin. To determine the recipients, each state — there are 10 states plus West Berlin — has one vote in a committee within the Ministry of Economics; the federal government has 13 votes; a three-fourths majority is required. The result is that individual state interests can seldom dominate the process. While a regionally concentrated industry may lobby at the state level, and the state may wish to grant aid, the industry may not receive assistance if it cannot attract support above a regional level.

The Program for the Improvement of Regional Economic Structure, established in October 1969, identifies less-developed regions according to the shortage of employment opportunities, income per capita, and the level of regional infrastructure. The criteria consistently favour viable investments which can secure long-term employment. The 1977–80 plan (Peacock et al., 1980, p. 104), the sixth under the program, made provisions for an investment allowance to cover up to 10 percent of the costs of projects in assisted areas, a discretionary investment grant of up to 25 percent of project expenditures, European Recovery Project-funded “soft loans” to small and medium-sized businesses for projects ineligible for investment allowances and grants, and a special depreciation allowance with an initial allowance of 50 percent. The special depreciation allowance is available only in the Eastern Border Zone and in West Berlin. Support ceilings for the discretionary investment grant are 15 percent on investment in normal-growth areas, 20 percent in areas fairly close to the Eastern border, and 25 percent on the border zone (OECD, 1981b, p. 4). These ceilings apply to industrial investment for the establishment and extension of facilities. The ceiling is 10 percent for reorgani-

zation or basic rationalization. To establish eligibility for assistance, each project must create 50 new jobs or provide a 15 percent increase in the employment level of a firm. Goods produced must be marketed on an inter-regional scale.

Applications from industry associations for aid must be approved by a bank, and the bank must commit a substantial proportion of the funds required. This condition ensures an important role for private sector institutions in the provision of regional aid. If the proposal is approved by the Ministry of Economics, government assistance is structured in the form of a loan by the firm's bank, guaranteed by the government; the private sector lender assumes the responsibility for administering the investment (Trebilcock et al., forthcoming). The *Kreditanstalt für Wiederaufbau*, a government-owned bank founded in 1948 to promote the West German economy, may make loans to the firm's bank to enable it to provide financing for the regional aid project. Since loans to firms are generally provided through the borrower's private bank, which guarantees repayment of the loan to the *Kreditanstalt*, loans are usually made to healthy rather than weak firms, to protect the private bank's investment.

ASSISTANCE TO AEG TELEFUNKEN, AG

The rescue of AEG Telefunken in 1982 was an exceptional case of crisis management in the German economy. AEG was established in 1883, and it is considered, along with Siemens, another electronics company, and Krupp, an industrial conglomerate, to be one of the founding corporations of modern Germany. By 1970, AEG was the second-largest manufacturer of electrical equipment in West Germany, next only to Siemens. Although AEG was considered an electrical equipment manufacturer, it was highly — and probably excessively — diversified. The only connection among its wide variety of products was that they were all electrical.

In the early 1970s, AEG was affected adversely by low-cost competition from the Far East. High interest rates increased the cost of servicing the company's debt, which had accumulated in a period of corporate acquisitions in the 1960s, and an over-valued deutschmark damaged foreign sales.

In 1976, the supervisory board appointed Walter J. Cipa as chief executive. He sold the company's money-losing operations such as its stake in *Kraftwerk Union*, a joint venture with Siemens which had cost AEG over \$500 million. In 1978, AEG reported losses of \$173 million on sales of \$7 billion, and its employment level fell by 30,000 to 105,000 employees in West Germany. The Company's debt level had reached \$3.8 billion.

In late 1979, AEG was in serious trouble. Labour leaders approached the government in Bonn to take a role and invest in the company to save

jobs. West Germany's business and financial leaders were nervous about state involvement and realized that they would have to assist AEG to forestall government intervention. Dr. Hans Friedrich, chief executive of the Dresdner Bank, AEG's house bank, proposed a rescue plan which involved a \$500 million financial package. A consortium of 24 banks would provide \$376.2 million in new equity, bringing their combined holdings to 65 percent of AEG's outstanding shares. The banks also agreed to reschedule much of AEG's debt, both long term and short term. Heinz Durr replaced Cipa as chief executive. Durr was able to cut AEG's losses from \$430 million in 1979, to \$125 million in 1980,³ but losses increased again in 1981 and 1982. High interest rates and poor markets prevented further gains.

In 1982, the Dresdner Bank approached West Germany's finance minister Manfred Lahnstein and Economic Minister Count Lambsdorff, for help in rescheduling AEG's debt and providing new loans. AEG's difficulties were now too great for the banks to solve alone. Chancellor Helmut Schmidt's government was under pressure to save jobs, since unemployment had reached 8 percent in Germany. Companies in the key auto, machinery, construction and chemical industries were reporting sharply declining profits and announcing layoffs or reduced working hours. A record high number of bankruptcies was expected in 1982.

By August 1982, the Bonn government agreed to back approximately 40 percent of the financing that AEG would need to the end of 1983. The government immediately provided AEG with \$239 million in loan guarantees to finance export sales, on condition that the banks provide \$100 million in new loans. Additional assistance depended on proof of the firm's viability. The government, however, rejected any possibility of taking equity in the company.

Shortly after the rescue plan was determined, Dresdner Bank announced that AEG had collapsed and would reorganize under *Vergleich*. This legal procedure would permit the company to write off 60 percent of its debt if AEG's reorganization plan was approved before March 9, 1983, by a majority of creditors holding among them at least 80 percent of the debt. The alternative to accepting 40 percent of their claims was AEG's bankruptcy. The impact of *Vergleich* was that the 24 exposed banks would have to absorb 60 percent of AEG's \$2 billion debt. Dresdner Bank faced a \$100 million loss, which would equal its 1982 earnings, and Commerzbank would be unable to make a 1982 dividend payment. Durr also announced that 20,000 employees would be laid off. He planned to create a smaller profitable company from AEG's heavy electrical equipment operations. This company would employ 60,000 workers and would make annual sales equivalent to approximately 60 percent of those of AEG. Other divisions of AEG were to be sold or were to become minority holdings.

Labour leaders reacted to the announced layoffs by calling on the government to take equity in the company. Although the Social Democrats needed labour support in the upcoming electoral contest against the Christian Democrats in the state of Hesse, Schmidt refused. In late 1982, the government agreed, instead, to guarantee up to \$440 million in new loans to AEG. An independent audit, commissioned by the government, had confirmed that the company could survive with the new loans and reduced operations. The State of Hesse agreed to grant loans of up to \$400,000 at subsidized rates to any supplier of Telefunken headquartered in Hesse. The banks provided \$800 million in new loans, \$400 million of which were government guaranteed.

By 1983, AEG was regaining strength and seemed likely to break even in 1984. Its employee level was down to 60,000 in Germany and 76,500 world wide. The company now specializes in telecommunications and defence-related technologies and has largely left the consumer-products business.

Sectoral Programs

The Steel Industry

BACKGROUND

Prior to World War II, the nations which later were to join the European Coal and Steel Community (ECSC), including Germany, produced 40 to 50 percent of world steel and accounted for 80 percent of world trade in steel (Tsoukalis and da Silva Ferreira, 1980, p. 358). In 1951, West Germany signed the Treaty of Paris which created the ECSC. The 1950s and 1960s were periods of rationalization of the steel industries of member countries. During the 1960s, Deutsche Bank, which had a director or senior staff member on the supervisory boards of almost all of the largest steel companies, relied on the long-term market forecasts of the German Iron and Steel Association to encourage mergers of companies in an effort to deal with the situation of oversupply and falling profits. Although these mergers produced successful companies such as Thyssen, by 1973 the West German steel industry found itself part of a worldwide steel crisis. In 1975, steel production in West Germany fell by 25 percent (Esser et al., 1982). The first phase of the steel crisis affected the economically weakest producers in the old mining and steel region of the Saar. The region suffered the disadvantage of an inland location at a time when a coastal location was considered necessary to reduce transportation costs. Moreover, the Saar steel industry was dominated by small enterprises with an unfavourable product structure (low value-added products), a narrow capital base, and investment and moderniza-

tion levels below the national average for the industry. The steel crisis quickly revealed these structural problems, and measures were taken to restructure the Saar industry. By 1980, however, the steel crisis affected the centre of West German steel production in the Ruhr. Unlike the Saar, the Ruhr was characterized by continuous rationalization and modernization, take-overs and mergers which had created larger firms, and diversified, high value-added production. Again, the Bonn government attempted to assist the industry by encouraging further mergers.

GOVERNMENT INTERVENTION

The European Coal and Steel Community

Under the ECSC Treaty, coal and steel policy may be withdrawn from the competence of individual member countries and made subject to Europe-wide regulations if the High Authority of the ECSC considers this step necessary. West Germany has generally resisted ECSC action. In 1975, the Bonn government did not declare a crisis in the steel industry, as did France, the United Kingdom and Italy, but showed more concern about subsidies being granted by other governments to their steel industries, and the negative effect these subsidies had on West German competitiveness. West Germany argued that the crisis was cyclical, not structural, and opposed state intervention either at the national or at the ECSC level. At this time the steel industry contributed 4.5 percent to the total net output of West Germany's manufacturing industry. By 1978, steel's contribution had fallen to 3.5 percent (Olig, 1980, p. 427). When the crisis worsened, in 1976, West German producers extended their existing "rationalization groupings" or crisis cartels, such as Thyssen,⁴ to include Arbed in Luxembourg and the Dutch steel industry in the north. A group named "Denelux" was formed to represent the interests of these producers in Brussels. This step was equivalent to the application of the crisis provisions of the Treaty of Paris, which set up the ECSC. European Community concern that Denelux might become a West German-controlled cartel because that country's companies were dominant led to the creation of Eurofer in 1979. This group assists the Brussels authorities to control steel production in order to promote inter-European rationalization. Eurofer now represents approximately 95 percent of production (Tsoukalis and da Silva Ferreira, 1980, p. 360).

The ECSC has also used measures other than the creation of a producers' cartel to address the problems of member steel industries. In January 1978, a minimum-price system was established for certain steel products, to forestall the diversion of steel to the EC from American markets, following the introduction of the Trigger-Price Mechanism in the United States. Once that mechanism was in place, low-cost steel producers no longer could sell in the United States without prompting an

investigation, and they were searching for other markets. In the same year Voluntary Restraint Agreements were negotiated with several countries, including Japan. Steel cargoes which did not respect EC prices would be fined up to 25 percent of their value. Although, as a result of these policies, EC prices temporarily rose by 20 to 25 percent in 1978, by mid-1980 they had fallen from that level by 13 percent (Curzon-Price, 1981, p. 89).

Concurrently with these measures, in 1977, the EC accepted the Davignon Plan, an anti-crisis series of policy instruments designed to grant the European steel industries a breathing space in which to restructure and modernize. In 1979, administration of this plan was made feasible by the creation of the Eurofer cartel, which centralized control over the steel industries in all EC-member nations. Implementation of the Davignon Plan began early in 1977, but the plan was not very successful, since most European plants continued to operate with excess employment and at less than optimum capacity. In October 1980, the plan was reinforced by the introduction of compulsory production quotas which covered 80 percent of all steel products of more than 300 firms. Firms were required to present a daily production report to the EC's central computer, which would allocate quotas. Unused quotas could be sold among firms. The quotas were enforced by 100 inspectors and a system of fines. ECSC policy had evolved from protecting EC production from imports to orderly market sharing within the Community. Also included in the Davignon Plan was a system of official minimum prices under which no EC producer could market its steel products.

West Germany reacted negatively to this regulation, since the rule penalized efficient operations. In March 1981, its concerns were addressed when EC members agreed to phase out subsidies for their steel industries by 1985.⁵ The quota system, however, was to be retained.

ASSISTANCE MEASURES BY THE WEST GERMAN GOVERNMENT

Assistance to Investors

The view of the West German government is that industrial adaptation is primarily a matter for industry to resolve with the banks and the trade unions. Although more than one-third of all West German steel production is exported (Esser et al., 1983, p. 111), and although the steel industry was threatened by oversupply resulting from international price wars in the 1970s, the state resisted intervention. During this period the industry did experience rationalization, closures, specialization and concentration of production, but received minimal government aid.

The Bonn government was forced to become involved in 1977/78, when the crisis hit the heart of steel production in the Saar. Mass

redundancies and bankruptcy threatened the major producers, and the threat prompted the Saar state government (Christian Democrat) and the federal government (then SPD-FDP) to develop a rationalization program. The governments negotiated privately with Luxembourg's Arbed steel concern, which had interests in the Saar steel industry, and with the union representing steelworkers, I.G. Metall. Since the scale and consequences of the problem exceeded Arbed's ability to handle them, a "crisis cartel" was formed with the participation of the two governments, the union, and the steel companies involved.

At the time of the crisis, steel production had been concentrated in two steel firms in the Saar. Arbed gained control of the affected companies, which became Arbed-Saarstahl, and obtained financial aid from the Saar and the federal governments in return for implementing a rationalization program that was to have the approval of the public accountancy firm, Treverbeit AG, and to meet certain structural requirements of the state government. These requirements included the integration of crude steel and rolled steel production at one site, to rationalize production. Luxembourg's Arbed received a total of DM 1.3 billion in federal and Saar assistance in loans and loan guarantees to cover Arbed's investments (Olig, 1980, p. 436). This massive industrial restructuring program was accomplished with a minimum of labour conflict, since the unions negotiated successfully for monetary compensation and other assistance. In November 1982, however, Arbed Saarstahl was faced with imminent bankruptcy. With a local unemployment rate of over 12 percent and the prospect of the loss of 30,000 more jobs, the federal and Saar governments provided a special bridging loan of over DM 1 billion (Esser et al., 1983, p. 111). Further assistance was provided in 1984, and assistance may again be provided in 1985, since it is strongly endorsed by the new Social Democratic state government in the Saar.

In 1981, overproduction threatened mass redundancies and corporate crises in the Ruhr during the second phase of the steel crisis, even though Ruhr steel operations had undergone a process of continuous rationalization in the 1970s. Negotiations began among the state and federal economic ministries, the union I.G. Metall, which was represented on the supervisory boards of the companies involved, and which was concerned about the impact of rationalization on workers, and the Deutsche Bank, which was also represented on the companies' supervisory boards. The companies involved were Kruppstahl AG (which had been bailed out by the federal government in 1967 on condition that it become a publicly traded company), Thyssen, Hoesch, Kloeckner and state-owned Salzgitte. In June 1982, the problems worsened, and the industry requested assistance in the amount of DM 14 billion. By year-end half the work force was on short time. In January 1983, a commission of three independent "moderators" delivered its report to the federal government. The commission recommended that in return for aid of

DM3 billion, the five steel firms of the Ruhr region should be merged into two groups (Esser et al., 1983, p. 111). In a series of mergers a "Rhine group" made up of Thyssen and Kruppstahl and a "Ruhr group" formed of Hoesch, Kloechnner and Salzgitter would be created. Major political opposition from the state government of North-Rhine Westphalia (in the Ruhr) was unresolved by March 1983. The commission's recommendations, therefore, have not been fully implemented.

Further assistance included measures to promote research in the iron and steel industry. These measures were implemented in 1978, for a six-year period, within the framework of the priority-technology programs of the Federal Ministry for Research and Technology. The ministry provided grants to assist projects aimed at process development and improvements in the finished product and its applications. Grants were paid on completion of research projects, which were funded substantially by the recipient. A portion of future income from royalties was to be paid to the agency which made the grant. By mid-1980, 200 projects had been submitted, and 64 had been approved (Olig, 1980, p. 434).

Assistance to Labour

The principle of co-determination makes negotiations between unions and employers a main feature of change within the steel industry. As part of the restructuring of the Saar steel industry, the union was guaranteed that there would be no employee dismissals during restructuring (Sirs, 1980, p. 175). In the event of job transfers, wages and salaries, including premiums and bonuses, are guaranteed for five years. In return for guaranteed wages, workers must accept alternative jobs that they can reasonably be expected to perform; a joint industry-union commission resolves disputes. Works Council members are informed at least monthly of market and production plans. The object of the "social plan" is the coordination of production so that workers can be transferred to other works within the new steel group. By achieving the greatest possible equalization of available jobs throughout all works, labour dislocation is minimized. Although this plan adds to the cost of restructuring in the Saar steel industry, it makes industrial adjustment socially acceptable. Funds to implement the "social plan" were included in the loan guarantee to Arbed-Saarstahl.

The ECSC has proposed measures to encourage early retirement of iron- and steelworkers. It plans to assume partial responsibility for the loss of wages resulting from measures aimed at phasing out jobs.

THE POLICY-MAKING PROCESS

The main employers in the Ruhr and Saar regions are the steelworks. Thus industrial adjustment and its resulting social costs have not been left solely to market forces. The government has taken action in order to

prevent massive unemployment. Loan guarantees have been provided to assist in restructuring, but the actual process of restructuring the steel industry has been left largely to private interests. The reorganization plan was developed in a process of negotiation and consensus among the interested economic actors.

IMPACT OF INTERVENTION

Labour and capital have moved out of employment in the steel industry as the industry declined by 15 percent (or 50,000 jobs) from 1974–80 (Esser et al., 1983, p. 111). By September 1982, the employment level had reached 180,000 persons, a drop of 20,000 from December 1979.⁶ From 1974 to 1980, crude steel production fell by almost 50 percent, as did rolled steel capacity (*ibid.*). Successful steel companies, such as Thyssen, have diversified out of steel and have increased the value-added of their remaining steel products (“Reforging a Steelmaker,” 1980).

The Shipbuilding Industry

BACKGROUND

West Germany had the world’s third-largest shipbuilding industry in the 1950s. By the 1960s, however, that industry was facing severe competition from Japan. From 1957 to 1974, its world-market share fell from 17.3 percent to 6.4 percent (Esser et al., 1983, p. 115). By 1979, that figure had fallen to 4.4 percent. New shipbuilding completions, calculated in compensated gross registered tons (GRTs), a measure of total cubic capacity, fell from 1,468,000 in 1976, to 1,029,100 in 1978 (“Shipbuilding,” 1979, p. 8). New order intake, also measured in compensated GRTs, fell over the same period from 726,100 to 535,800 (*ibid.*). The employment level declined by 12.5 percent from 1968 to 1977 (Peacock, et al., 1980, p. 89). This decline had an important regional impact, since West Germany’s shipbuilding industry is concentrated in four coastal states.

The decline in the shipbuilding industry, which is evident from these figures, was precipitated by the 1973 oil crisis, which reduced demand for tankers. A fall in shipbuilding orders furthered the decline in the steel industry, with which shipbuilding is closely linked. Structural over-capacity has resulted from an increase in the number of nations with shipbuilding industries, the greater productivity of ships, lighter cargoes as countries seek to become industrially competitive by increasing the amount of processing done locally, and increased competition from air-cargo services. The tendency of the 1960s, to longer, more profitable trade routes has also been reversed.

GOVERNMENT INTERVENTION

There are a number of programs, both within the general economic policy framework and specifically addressed to the shipbuilding industry, which are employed as instruments to assist adjustment. Credit assistance is offered to foreign buyers of West German ships through the *Kreditanstalt für Wiederaufbau*, which provides financing at low interest rates from the federal government and from the European Recovery Program, established initially under the Marshall Plan. The program is administered by the Ministry for Economic Cooperation. From 1976 to 1977, DM300 million were made available for the program. The federal government also offers West German yards a construction subsidy of 17.5 percent on the total cost of new ships (Peacock et al., 1980, p. 105). To assist construction further, a customs-duty exemption is granted under the administration of the federal minister of economics for the importation of materials for the building of ocean-going ships. The benefit of this program is minor, however, since most inputs are produced domestically. West German shipping companies are granted a 10 percent price reduction, low-interest loans and a more rapid depreciation schedule for orders placed with domestic shipbuilders (de Carmoy, 1978, p. 50). Total assistance to the shipbuilding industry from these three programs is set out in Table 8-1.

From 1970 to 1975, federal government financial assistance to shipbuilding accounted for only 2.6 percent of industry revenue, a much lower figure than the 24.1 percent for France or the 14.6 percent for the United Kingdom, and approximately equal to assistance provided in Japan (Peacock et al., 1980, p. 97).

West German shipbuilding is also assisted through joint federal-state programs. In 1977, when the federal government budgeted DM450 million for construction grants (Peacock et al., 1980, p. 105), the coastal states (Hamburg, Bremen, Lower-Saxony and Schleswig-Holstein) agreed to supplement these grants with state grants for projects partly supported under federal programs. All of the major shipbuilding states have given selective assistance to shipbuilding companies, including the use of state-owned land and heavy public investment in infrastructure at ports. The largest shipyard in West Germany, HDW, is 75 percent owned by Salzgitter, the steel conglomerate owned by the federal government, and 25 percent owned by the state of Schleswig-Holstein.

In 1979, a program developed by the federal government was aimed at diversifying the economies of coastal states (Esser et al., 1983, p. 116). Within this program, assistance was granted to AG Weser, the second-largest shipbuilding company in West Germany, which belongs to Krupp. In agreement with I.G. Metall, AG Weser sought to change its product line from large tankers to specialized, technologically advanced ships. In 1980, the company's work force was reduced by half. The union

TABLE 8-1 Government Financial Assistance to Shipbuilding

	1970	1971	1972	1973	1974	1975	1976	1977	1978
Grants for shipbuilders (DM millions)	27.6	29.5	37.1	66.9	98.9	99.6	83.7	83.1	106.9
Construction grants (DM millions)	87.3	81.9	56.3	60	60	118.3	150.1	155.0	255.0
Subsidy element in credit assistance for buyers (DM millions)	156.5	156.5	156.5	303.5	303.5	303.5	329.4	329.4	329.4

Source: Alan T. Peacock et al. *Structural Economic Policies in West Germany and the United Kingdom* (London: Anglo-German Foundation for the Study of Industrial Society, 1980), p. 103.

protected the position of the remaining workers with a three-year earnings' guarantee negotiated with the company.

THE POLICY-MAKING PROCESS

Sectoral aid to the shipbuilding industry has strong regional implications. Employment is concentrated regionally in the four coastal states. Declining employment levels have not been a primary motivator of government action, since these areas do not suffer from high unemployment. Assistance has been offered to aid an export-oriented industry while the Deutschmark was overvalued, and to match assistance given by other countries to their shipbuilding industries. The world market is highly transparent — there are several dozen trade magazines in Europe alone which publish statistical data on the market — and the industry is highly competitive (Fante, 1975, p. 178). Industry lobbies, such as the Association of the German Shipbuilding Industry, have argued against subsidies and against an EC assistance policy.

IMPACT OF INTERVENTION

West German shipyards have been in the forefront of worldwide technological advances in production methods and have maintained a high rate of investment. Most shipbuilding companies also have greatly diversified their interests so that of the six largest shipbuilders, four are general engineering companies. Although the industry's world-market share has declined steadily, this statistic may be misleading, since export turnover as a percentage of total turnover has increased from 45.2 percent in 1968, to 53.0 percent in 1977 (Peacock et al., 1980, p. 89). This would indicate that although the industry is in decline, elements of it

TABLE 8-2 West German Shipbuilding: Output

	1968	1969	1970	1971	1972	1973	1974	1975	1976	1977
Turnover of industry excluding non-shipbuilding activities	2,645	3,178	3,220	4,018	4,027	4,891	5,743	6,293	6,621	6,545
Percent of export turnover	45.2	47.7	36.2	41.5	48.2	55.6	44.7	60.5	56.6	53.0

Source: Alan T. Peacock et al. *Structural Economic Policies in West Germany and the United Kingdom* (London: Anglo-German Foundation for the Study of Industrial Society, 1980), p. 89.

remain internationally competitive. Moreover, the turnover of the industry has steadily increased since 1968, as is evident from Table 8-2. Therefore, government assistance to the industry, which has emphasized a reduction in capacity and a shift to employment out of the industry, may have been successful. In terms of 1977 output, the West German shipbuilding industry was the fourth largest in the world.

The Coal-Mining Industry

BACKGROUND

Output in the West German coal-mining industry has suffered an accelerating rate of decline of 0.8 percent in 1960–65, a further 2.4 percent decline in 1965–70, and 6.7 percent drop in 1970–74. Employment also declined by 5 percent, 8.1 percent and 5.2 percent in the same periods (Fels, 1976, p. 103). However, productivity has increased as the absolute decline in employment exceeded the absolute decline in output.

During the 1960s, West Germans substituted other energy sources for coal; the share of coal in national primary energy consumption fell from 61 percent in 1960, to 29 percent in 1970, while in the same period the share of mineral oil grew from 21 percent to 53 percent (Fels, 1976, p. 102). However, coal may be entering a period of growing worldwide demand following the oil crisis and as a result of disappointment with the nuclear energy alternative. While the West German price of coal increased from 92 to 95 percent between 1970 and 1976, the price of heavy fuel oil, which competes with coal in the power-generation market, increased by 145 percent. In the corresponding period, the price of crude oil jumped by 300 percent (United Nations, 1978, p. 82).

GOVERNMENT INTERVENTION

Coal mining is the only example of a West German industry in long-term decline which has received maintenance assistance from the federal

government on a large scale. The rationale has been to secure the country's only indigenous energy supply and to avoid unemployment in one of the most important industries in the Ruhr. Effective total assistance to coal mining was 128 percent above the average level of assistance to manufacturing industries in 1975, as compared to textiles which received assistance at a level 25 percent above that average (Fels, 1976, p. 101). In 1978, support totalled DM5,000 million (Peacock et al., 1980, p. 52).

From 1958 to 1967, coal mining was assisted by import quotas and a specific import tariff, subsidies for coal transport, rationalization and shutdowns, taxes on heating oil, and a voluntary restraint agreement on imports of the mineral oil industry, subsidies on coke used in the iron and steel mills, and the promotion of coal inputs in existing and new power plants. In 1968, the *Law on Adjustment and Restructuring of Coal Mining* was aimed at comprehensive structural reorganization. A Federal Commissioner for Coal Mining was appointed, with powers to allocate production among mines, guide investment, and promote rationalization and concentration. Mergers were sought to consolidate the industry. If companies failed to achieve an "optimal size" through the merger of a majority of mines, they were threatened with the withdrawal of financial assistance. Twenty-six companies in the Ruhr merged to form Ruhrkohle AG, while four companies merged into Eschweiler Bergwerksverein and Saarbergwerke AG. The latter company was owned jointly by the federal government and the Saar state government.

In the 1970s, principal direct financial support was adjustment aid to promote investment, reorganization and closures. Principal maintenance support consisted of taxes on competing sources of energy (the mineral-oil tax and the *Kohlepfennig* paid by electricity consumers) and a mix of voluntary and mandatory requirements for the electricity and steel companies to purchase domestic coal.

IMPACT OF INTERVENTION

The major part of the coal industry is composed of the three large companies created in 1968. Productivity fell during the 1970s, and direct assistance expenditure in 1974 was DM1,721 million (in 1968 DM), compared to DM1,008 million spent in 1968 (Fels, 1976, p. 109). From 1960 to 1970, domestic coal consumption remained virtually unchanged, while imports increased slightly by approximately 2 percent annually (ibid. p. 103). Employment in the industry has fallen by 230,000 workers since 1978, to under 180,000 workers. Further reductions seem likely. Adolf Schmidt, the miners' union leader, claims that "this sector will need subsidies not just temporarily, but forever" ("West Germany," 1984, p. 11).

Conclusions

In contrast to the American policy approach to declining industries and analogous to the Japanese model, the West German policy process is relatively depoliticized and technocratic. As in Japan, consensus among major interests is the basis for policy formulation. But whereas in Japan, labour has been excluded from political influence, in West Germany, all major interests are represented institutionally in well-integrated peak organizations with national mandates and perspectives. Although the inclusive nature of West German policy making has sometimes made crisis management a slow process, as in the case of the Ruhr steel negotiations, consensus rather than conflict surrounding ultimate economic objectives has generally facilitated the adjustment process.

Crisis interventions in West Germany are special cases and are usually relatively sophisticated. Adjustment is "private-sector led," and the banks and industry associations play major roles in containing conflict. As in Japan, there are well-developed anticipatory policy instruments. Most assistance measures are implemented within the context of established programs, such as employment, social welfare and regional development policies. In accordance with a preference for private sector-led adjustment, West Germany's policy approach has often utilized instruments such as "crisis cartels" or mergers. Under German anti-trust laws cartels are permitted in individual cases where the firms affected by a permanent reduction in demand undertake a planned permanent reduction of existing overcapacity (OECD, 1981a, p. 17). German policy makers prefer to rely on market forces to allocate resources, and policies to assist adjustment follow the Japanese pattern of emphasizing retraining and mobility, rather than compensation. The state's role is secondary: it is to maintain stability so as to allow market forces to function more smoothly. The result has been a balanced mix of economic and social instruments designed to speed the adjustment of capital and labour on the sectoral, rather than on the firm, level.

Specifically, West Germany's policy approach to the steel, shipbuilding and coal industries has been to resist government intervention except in periods of extreme crisis. West Germany's steel industry received assistance only when the crisis hit the heart of steel production in the Saar and Ruhr regions, threatening mass redundancies and bankruptcies. In both cases, the approach was to merge existing companies, which were then provided with government credit. The process of reorganization, however, is left to the private sector. Dislocated workers have been assisted by "social plans" negotiated within the merger "package." Negotiations between unions and employers have been a main feature of change within the industry. The steel industry is now regaining its health as companies diversify out of steel and concentrate

on high value-added products. Assistance to the shipbuilding industry has been of longer duration, in response to the regional concentration of the industry. Still, assistance is a much smaller proportion of industry revenue than it is in other major shipbuilding nations. Credit assistance and subsidy programs have encouraged the diversification of the industry, which has been in the forefront of worldwide technological advance in production methods. It is within the coal industry that assistance policies have had the least success. Protection, cartelization and direct financial support for reorganization and investment have not improved greatly the state of the industry, which remains in decline. Thus, in most instances, West German policy makers have been relatively successful in managing industrial decline. The participation of labour, industry and major creditors in planning the reorganization of declining sectors has contributed to the legitimacy of the process, which has been left largely in the hands of the private sector. Government intervention, except perhaps in the coal industry, has mostly been confined to temporary "crisis management."



Conclusions

Positing a relationship between microeconomic policies and robust levels of growth, productivity and employment is a highly speculative exercise. Macroeconomic endpoints are the product of an exceedingly complex and intricate process which involves myriad factors. By definition, exclusive attention to a subset of these factors is bound to involve neglect of other important variables. Moreover, the effect that an isolated variable has on general economic performance is very difficult to assess. As Olson (1982, p. 10) has observed, "Only the British have Big Ben and only the Germans eat a lot of sauerkraut, but it would of course be absurd to suggest that one is responsible for slow British growth and the other for fast German growth."

In view of the difficulties inherent in constructing a causal relationship between specific microeconomic policies and general economic performance, what conclusions can we glean from this study? Perhaps the simplest and most defensible conclusion is that which links a country's economic performance to the rapidity with which resource factors are withdrawn from declining industries and redeployed in expanding ones. An obvious policy implication of this conclusion is that those countries which possess an industrial policy framework which is conducive to factor mobility will be better able to ensure that national wealth is maximized by directing resources to their most valuable uses.

Certainly, this hypothesis is consistent with the tenets of general economic theory. The extent to which it can be supported on the basis of the empirical studies contained in the body of this survey will be explored in the next two sections. In the first section, we shall review briefly the general economic performance of the countries examined in the survey. We shall offer a crude ranking of the relative performance of

these countries' economies. In the following section, the overall effect of each country's industrial policies on resource mobility will be evaluated. This "overall effect" will be determined by examining the various policy instruments that have been used by policy makers in dealing with the challenges posed by industrial decline. Again, a crude ranking of the efficacy of the policies employed by the countries studied will be developed to address the problems posed by industrial decline. The section will conclude by comparing the performance ranking generated in the section entitled "Comparative Economic Performance" to the industrial policy ranking developed in the section "Instrument Choice." The purpose of this exercise is to illuminate the strength of the correlation between economic growth and the policies designed to facilitate resource mobility.

Once the robustness of our hypothesis is evaluated, we shall proceed to identify the salient political and institutional features that are favourable to the evolution of an industrial policy mix which is conducive, rather than detrimental, to growth. Finally, we shall discuss the desirability of importing some of these features into the Canadian policy setting.

Comparative Economic Performance

To assist in gauging the relative economic performance of Canada and the six countries surveyed in this study, we have selected four broad measures of macroeconomic performance: rates of real growth, productivity, unemployment and inflation. The decision to present four measures of performance rather than just one reflects the difficulty of determining which measure is best able to stand as proxy for a country's economic vitality. The rates in Table 9-1 are calculated for two successive periods. Differences in the methodologies used by the countries to generate these rates have been ignored as have differences in the stages of the business cycle where each country stood at the beginning and end of the time periods compared. These are important limitations of the data, but they probably do not distort significantly the broad generalizations that we offer.

Clearly, in terms of growth and productivity, Japan has demonstrated the strongest performance over the two periods examined. Conversely, the United Kingdom has shown the least spectacular rate of growth over the two periods, while the United States displayed the poorest growth rate of productivity in the 1960-71 period and tied Canada for the most dismal productivity rate in 1972-81. The lowest levels of unemployment were observed in West Germany and Japan in both periods, and the highest in Canada and the United States in 1960-72, and in Canada and the United Kingdom in 1972-82. Last, while the high levels of growth observed in Japan were accompanied by relatively high rates of inflation in the period 1960-71, by 1972-80 the inflation rates in the other countries had matched or surpassed Japan's inflation rate.

TABLE 9-1 Average GDP Growth, Productivity Growth, Unemployment and Inflation Rates, 1960-71 and 1972-81¹

	Canada	Australia	France	West Germany	Japan	United Kingdom	United States
Growth of real GDP (percent change)							
1960-71	5.2	5.8	5.7	4.9	10.4	3.0	3.6
1972-81	3.8	3.2	2.6	2.2	4.7	0.9	2.8
Growth of productivity (real GDP per person employed, percent change)							
1960-71	2.6	2.5	4.8	4.2	8.6	2.8	1.8
1972-81	0.8	1.6	2.5	2.6	3.6	1.8	0.8
Standardized unemployment rates (percentage of total labour force)							
1964-71	4.4	1.7	2.0	0.8	1.2	2.9	4.3
1972-82	7.8	5.3	5.6	3.7	2.0	7.8	7.2
Inflation rate (percent change of consumer price Index)							
1960-71	3.0	2.9	4.9	2.9	5.7	4.4	2.1
1972-81	9.9	11.9	11.4	5.8	9.9	15.5	9.3

In terms of general rank ordering, it seems safe to suggest that Japan's performance was the strongest in the two periods, while the United Kingdom's performance was the weakest. Between these two extremes stood (in our estimated order) West Germany, Australia, France, Canada and the United States during 1960-71, and West Germany, Canada, Australia, the United States and France during 1972-81. It is important to note that while the poles are strongly defined by Japan and the United Kingdom in both periods, the absolute differences in performance among the remaining countries are more subtle. This observation applies especially in the second period.

Instrument Choice

In Chapter 1, we identified a number of instruments that could be deployed to address the problems of declining industries. We then evaluated the efficacy of these instruments within economic, ethical and political frameworks. This exercise revealed that when evaluated against both economic and ethical considerations, labour-adjustment policies

were preferable to trade protection and industrial subsidies. When political considerations were evaluated, however, an inverse ranking of instrument choice was generated.

In this section, we shall identify the principal policy instruments that the countries surveyed have relied on to ascertain which economic, ethical or political factors are part of each country's policy menu. By focussing on the relative propensity that a country exhibits toward trade-protection instruments and subsidies over labour-market adjustment programs, conclusions can be advanced respecting each country's approach to structural adjustment. There is a danger, however, that in identifying each country's industrial policy mix solely according to the frequency with which certain policies are implemented, the nuances in the manner of the policies' implementation will be ignored. Although two countries may rely on the same type of instrument to achieve industrial policy objectives, the implications for resource mobility may be quite different. For instance, while labour-subsidy schemes have retarded the mobility of labour in some countries, in others these schemes have accelerated the pace of labour mobility. Thus any attempt to characterize the thrust of a country's policy toward declining industries must take account not only of the frequency with which policies are used, but also of the way in which a given instrument is applied. Accordingly, in the latter part of this section, we shall evaluate policies against a benchmark which incorporates both of these variables. This procedure will enable us to rank the policy mix of each of the countries studied according to their impact on structural adjustment, and to compare these results with the ranking which gauges relative economic performance.

Description of Instruments

TRADE PROTECTION

In Chapter 1, we identified the characteristics of trade-protection instruments which rendered them attractive to policy makers. The benefits accruing from the implementation of such measures are relatively highly focussed and quickly realized, while the costs are concealed, widely dispersed and not immediately felt. Nevertheless, the deleterious economic effects of the deployment of trade protection instruments place some constraints on their political viability.

Trade protection is a particularly blunt instrument for assisting a declining industry. Because of its general application, it is unable to focus specifically on the problems that beset an ailing industry. As we have seen from the cross-country survey of sectoral policies, an eroding market share may be a symptom of myriad distinct maladies that might plague an industry. Inflationary cost pressures on fixed-price contracts

in the British, West German and Canadian shipbuilding industries call for an entirely different set of policy prescriptions than does the increase of competition which the textile industries of those same countries face from low-wage countries. Yet reliance on trade restrictions treats both problems in an identical fashion.

Trade protection is seldom conditioned on an industry undertaking changes such as mergers, scrapping of excess capacity, or restructuring that will enable it to become more competitive internationally. Thus, even when firms in an industry use the profits deriving from trade protection to modernize production, such changes will tend to lack a coherent industry-wide approach. In the Canadian textile industry, trade protection has enabled firms to introduce new technology, but the changes introduced have not addressed the broader problems that the industry faces as a result of its comparatively high labour costs.

It can be argued, too, that unconditional trade protection may further exacerbate an industry's problems by luring new firms into an industry already facing the problem of production at less than minimum efficient scale. This problem arose when quotas were introduced in the Canadian footwear industry.

The lack of precision entailed by trade protection is underscored when the tariff is used to achieve regional policy objectives. Australia and, to some extent, Canada have both imposed trade restrictions on imported goods which compete with the products manufactured by industries concentrated in depressed regions. Again, the decision to employ such assistance devices is motivated primarily by political considerations. Whatever the case for regional assistance, it is clear that regional policy objectives could be realized more efficiently through the use of more finely honed tools. By this means, some of the distortions and misallocations engendered by trade restriction could be avoided.

Perhaps the most important deficiency that accrues from the deployment of trade instruments relates to their unconditional character. By definition, an industry which is the recipient of trade protection will be insulated to some degree from the vicissitudes of the market. As a consequence, firms have less incentive to accommodate themselves to changing world competitive conditions by initiating structural adjustment. Trade protection, unlike the sector-wide assistance schemes on which France and Japan have relied, is seldom extended on the condition that industry rationalize or restructure its mode of production. Indeed, if industrial adaptation occurs at all in a protected industry, it is often in spite of, not because of, trade protection. Moreover, such adaptation will occur only if policy makers resist the temptation to increase the level of protection enjoyed by an industry over time.

The Australian motor-vehicle industry exemplifies a situation in which policy makers continually revised the tariff schedule upward, in order to limit foreign imports to a fixed share of the domestic market.

Predictably, the industry, well sheltered from market pressures, made no effort to modify its established modes of production, and it has become one of the highest-cost producers in the world.

If protection is extended only temporarily, however, or if the level of protection is held constant and producers in other countries are able to surmount the tariff barrier by exploiting a shifting competitive advantage, the adjustment-retarding effects of trade protection may be muted. For instance, despite the strenuous lobbying efforts of industry and labour representatives from the Canadian shipbuilding industry, the Canadian government has refused to increase the level of trade protection or subsidy extended to the industry. Consequently, the industry has experienced a marked contraction in output over the last five years. It can be argued that this contraction has occurred at a pace conducive to the gradual withdrawal and redeployment of resources.

Perhaps a more effective way to encourage structural adjustment while offering industry a temporary respite from market pressures is to extend tariff protection on the condition that the schedule will be revised downward over time. This strategy allows industry a short "breathing spell" from foreign competition, during which changes can be made to increase production efficiency. This technique has been used successfully in the Australian whitegoods industry.

In sum, we suggest that with the exception of a few instances where a government is firmly committed to the notion that trade protection should shield an industry only temporarily from competitive pressures, the effectiveness of trade protection as an instrument of structural adjustment is weak.

REGIONAL POLICY

Another tool that has been widely used to aid ailing industries in developed countries is regional policy. Depending on the way in which regional policies are implemented, they may have either a negative or a moderately positive effect on structural adjustment. The United Kingdom and Australia provide examples of negative effects, while the experiences of West Germany offer instances of positive effects.

The United Kingdom achieves regional policy objectives through the use of a non-discretionary grant on capital expenditures. Ailing firms, which are highly concentrated in depressed regions, are among the major beneficiaries of the grant. The grant is unconditional and consequently tends to subsidize current levels and modes of production; this tendency reduces industry's incentive to rationalize, modernize or restructure plants.

The United Kingdom's regional assistance grant has undoubtedly contributed to the intractable nature of the problems faced by decision makers in fashioning solutions to industrial decline. Meting out assis-

tance to ailing firms on a regional basis has made forward-looking adjustment policies politically unattractive. Rather than encouraging migration to regions where industries are more competitive, the non-discretionary regional assistance grant has encouraged workers to remain in depressed regions, where they can continue to wield substantial political influence. Public housing policy in the United Kingdom has also seriously exacerbated the costs of relocation for workers in depressed regions. Motivated by a fear of alienating large blocs of voters, policy makers have continued to prop up failing firms so that output and employment can be maintained in those regions.

The regional assistance grant has not only served, on occasion, to perpetuate inefficient and uncompetitive production, but has also contributed notably to an industry's competitive disadvantage. For example, costs of production in the British motor-vehicle industry were increased significantly by inducing firms, through generous financial enticements, to set themselves up in regions far from markets for finished products or least-cost sources of inputs.

Australia's experience with the Special Assistance to Non-Metropolitan Areas (SANMA) scheme parallels many of the problems experienced in the United Kingdom. Unconditional aid to firms in depressed regions only reinforced the reliance of such firms on outdated, obsolete forms of production. (In fact, the textile industry consumed the majority of available funds.) Moreover, aid prevented the movement of labour to growth industries located in other parts of the country.

The Canadian experience with regional subsidies has encountered similar problems. Aid provided under the Department of Regional Economic Expansion (DREE) has nurtured the growth of firms in regions which are beset by significant locational disadvantages.

West Germany has enjoyed considerably greater success than have the United Kingdom, Australia and Canada in promoting adjustment by means of regional policy tools. This success is chiefly attributable to the positive adjustment bias ingrained in West German policy. The extension of large, ongoing, unconditional loans to declining firms is prevented by several statutory safeguards. First, regional assistance must entail new job creation. Secondly, to ensure that policy is not directed to regions or industries with no prospect of revitalization, regional initiatives must receive a vote of three-quarters of both the West German States and representatives of the federal government. A further check is provided by the requirement that West German banks participate in any regional aid package by offering matching funds to the recipient of the aid. Scrutiny by representatives from both orders of government and the private sector reduces the likelihood that aid will go to non-productive investments.

The West German regional policy program, while more sensitive to optimal resource allocation than are programs in other countries, is not

entirely immune from attack on efficiency grounds. The job-creation proviso included in the program will tend to introduce distortions into the optimal allocation of resources. Production processes in assisted firms will be skewed toward labour intensity even if this phenomenon does not represent the most efficient production technique. There is also a possibility that manufacturing firms will be enticed to regions where they might experience locational disadvantages.

For the purpose of the evaluation which follows in the Appendices to this chapter, we shall consider unconditional regional policy to be adjustment retarding. We shall deem moderately conducive to adjustment regional aid conditional on firms' initiating changes to their mode of production which will make them more competitive.

FIRM-SPECIFIC POLICIES

Firm-specific policies or "bail-outs" are relied on most frequently in the United Kingdom to arrest individual decline. This instrument also has been used in Canada, in a number of industries, under programs like the Enterprise Development Program (EDP); it has been used less frequently in the United States. The use of firm-specific assistance to achieve industrial policy aims starkly contradicts the goals of rapid efficient adjustments dictated by economic criteria.

For instance, firm-specific assistance under both the *British Industry Act* and the Canadian EDP has frequently been directed to marginal industry producers. Although firm-specific assistance is usually seen in terms of aid for rationalization and restructuring, the provision of government funds to these industries has often proved to be largely unconditional. This lack of conditions has allowed marginal firms to continue to rely on inefficient management and production techniques in maintaining production and employment levels.

Initially, in the United Kingdom, firm-specific aid was made available only on a "one-shot" basis. Yet regularly, the one-shot bail-out mushroomed into an ongoing commitment by government to ensure the continued viability of ailing firms irrespective of their potential performance. Moreover this commitment often culminated in the nationalization of the ailing firm. As a result, government became tied intimately to the success of firms receiving even marginal levels of initial assistance and had little ability thereafter to distance itself politically from the subsequent fate of the firm.

In Canada bail-outs were, in a sense, institutionalized by EDP. As in the United Kingdom, the large sums of virtually unconditional money disbursed under the program often went to subsidize the operating losses incurred by the recipients of such aid.

As an instrument of industrial policy, the bail-out is perhaps the least useful tool for facilitating rapid adjustment. In these terms, only firm-

specific grants clearly predicated on rationalization and restructuring can be considered even moderately conducive to adjustment.

SECTORAL POLICY

Since regional and trade-protection policies serve only as awkward tools of industrial policy management, and since firm-specific assistance often forecloses the possibility of any significant change in industrial structure, sectorally-based instruments are clearly important for accommodating trade and technological pressures. The comparative survey of policies toward declining industries reveals a great disparity in the choice of instruments employed to fashion solutions to sectoral decline. Consistently with the instruments they have used to address firm decline, policy makers in the United Kingdom adopted sectoral policies notable only for their reactive and ad hoc nature. In contrast, both the Japanese and French governments have played active roles in developing detailed policies for ailing sectors designed to force modernization, consolidation and contraction.

Unlike the often haphazard micro approaches entailed in firm-specific assistance policies, sectoral policies that are successful in arresting industrial decline are distinguished by their more coherent and comprehensive structure. This structure enables decision makers to deploy instruments to address decline in a more rational manner. The continued viability of specific firms is evaluated against an industry-wide benchmark; firms which lack the managerial skill or capital to regain lost market shares are either merged with larger, more competitive entities, or wound down altogether.

A central component of successful sectoral policy is the role played by a central agency in developing industry objectives and corresponding policies, and then implementing them by use of a range of instruments. In France and Japan, sectoral policy has been guided by state agencies, and in West Germany by private banks.

The existence of formalized communication ties not only enables coordinating agencies to acquire substantial amounts of knowledge of an industry, but also gives these agencies an opportunity to fashion policy that is more anticipatory and less reactive than is policy in countries lacking such structures. The West German and Japanese banks, by relying on the information furnished by their client industries, are able to detect difficulties in an industry long before these problems become apparent in large operating deficits and dramatic erosions of capital. At this early stage, relatively subtle policies may be able to place the firm on a stable footing and thus obviate the subsequent need to invoke heroic and often abortive measures.

If sectoral policy is to be effective, however, it is not sufficient that objectives simply be well defined; it is also important that they explicitly

acknowledge the need to promote, rather than retard, structural adjustment. In some cases, such as French shipbuilding, firms have been encouraged to use their fixed assets as a springboard for the manufacture of new and distinct products. On the other hand, the persistent tendency of successive U.K. governments to prop up and acquire "lame duck" firms reflects the reticence of such governments to recognize the need for industrial adaptation. Central industrial agencies, such as the Industrial Reorganization Corporation (IRC) and the National Enterprise Board (NEB), which were expected to play a major role in promoting adjustment, became vehicles for forestalling change. The mandate of these agencies sheds light on their activities; for instance, while the purpose of the NEB was to enhance the economic welfare of the United Kingdom, the board was also intended to be sensitive to the employment ramifications of its conduct. The dichotomous character of its enabling legislation differs markedly from the *Structurally Depressed Industry Law* (SDIL) in Japan. The SDIL, in forthright and unambiguous language, sets out the need for structural adjustment through rationalization, restructuring, modernization and contraction. Short-term considerations are relegated to a position of secondary importance.

This premium on adjustment can be observed in virtually all of the French, West German and Japanese sectoral studies. In each case, the extension of government aid to industry was predicated on firms undertaking vigorous efforts to achieve industry rationalization and restructuring that often entailed sharp capacity reductions. For instance, assistance to the West German steel industry was predicated on the express provision that the recipients of such aid make changes that would render them more competitive in the international marketplace.

Most important, rationalization and restructuring in these countries not merely required that government assistance be expended on improving the capital structure of declining firms, but was often conditional on firms cutting back employment and production, and scrapping excess capacity. For instance, sectoral policies which were fashioned to direct recovery of the French shipbuilding and West German coal industries, stipulated that firms respect ceilings on production in order to qualify for assistance. Sometimes, such as in the French and Japanese textile industry, and the latter's shipbuilding industry, assistance was predicated on the closure of marginal firms.

These programs stand in stark contrast to the Canadian experience with a sectoral based policy. In the Canadian textile industry, the sectoral policy initiatives served to insulate the industry from market pressures and did not centrally address problems of labour costs or ways to realize minimum efficient scale in industry structure. In essence, a starkly short-run perspective was brought to bear on what were obviously long-run problems.

Another feature which distinguished French, Japanese and West Ger-

man sectoral strategies from similar strategies in Canada, the United Kingdom, Australia and the United States was the range of instruments deployed to achieve industrial policy goals. The United Kingdom relied almost exclusively on unconditional assistance, while Australia, Canada and the United States extensively deployed tariffs and quotas to assist industry. Such a limited range of instruments inhibits the creativity and precision with which industrial policy is implemented.

In contrast, decision makers in France, West Germany and Japan have used a number of instruments to assist industrial restructuring. In Japan, cartels have been used with some frequency to coordinate capacity reductions, apparently with marked success in industries such as aluminum and shipbuilding. In France, an inflation-adjustment mechanism was implemented in the shipbuilding industry in order to decrease the uncertainty that afflicted the industry in its sales of ships on fixed-price contracts. In West Germany, a plethora of tax breaks and concessions is available to encourage structural adjustment. In all of these countries, the banking system can, to some extent, be used as an instrument to assist industry. Greatest use of banks as an instrument of industrial policy is made in Japan, West Germany and France. Banks can engineer rationalization plans for depressed industries by relying on their credit or equity leverage.

Labour-Adjustment Policies

Another instrument that has buttressed the success of sectoral policies in these countries has been sector-specific labour-adjustment schemes. Essentially, these schemes offer partial compensation to unemployed labour for the social and private costs imposed by their redundancy. Socializing the costs of adjustment has had the effect of tempering the resistance of labour to structural adjustment. In France and particularly in Japan, sectoral labour programs have extended generous levels of assistance in the form of retraining, mobility, and early retirement allowances. This assistance has compensated for the limitations present in general labour-adjustment programs.

Sector-specific labour-adjustment schemes have been employed in Canada; workers displaced in the textile, footwear, automotive and coal industries have been the beneficiaries of such aid. The majority of these programs, however, have enjoyed only limited success. In the main, the programs have been beset by overly stringent eligibility criteria that required the demonstration of a causal relation between specified government policies (reductions in trade assistance) and unemployment. Incorporating such provisions into labour-adjustment programs has reduced the number of workers taking advantage of the benefits. In addition, these schemes have provided low levels of benefits for positive adjustment. Mobility and retraining allowances which would assist

workers to migrate to more highly valued jobs were overshadowed by income-maintenance payments. Assistance based on income maintenance, when coupled with a sectoral focus, has seriously retarded labour adjustment. In this manner, sectoral labour programs have worked to contradict the adjustment goals espoused in other areas of sectoral policy.

From our comparative survey of general labour-adjustment programs, it is clear that the West German scheme has been most successful in offering an extensive menu of assistance to redundant workers. This assistance has given unemployed workers the skills and the flexibility to migrate rapidly out of declining sectors. The speed with which these adjustments have been made has reduced the private costs of dislocation sustained by individual workers. Socializing adjustment costs in this way has had the effect of deflecting demands for selective assistance by labour groups. Given the attributes possessed by the general West German labour-adjustment scheme, we shall use this policy as a benchmark with which to compare briefly the characteristics of programs in other jurisdictions.

In contrast to labour-adjustment programs in most of the countries surveyed, the West German adjustment scheme is universal in its coverage; workers eligible for unemployment benefits are entitled to take advantage of retraining and relocation allowances. Since the scheme is universal, there is no need to set up complex eligibility criteria to limit the ambit of the program. Thus protracted eligibility disputes are unnecessary in determining whether workers have been made redundant by firms undergoing structural adjustment (Japan) or suffering the effects of import competition (United States) or those of "specified government decisions" (Australia).

To ensure that workers enrol in retraining programs, the West German scheme includes a penalty provision which stipulates that workers who resist retraining will jeopardize the continuation of unemployment benefits. To blunt the edge of this requirement, workers undergoing retraining are eligible to receive the same level of benefits that they would be entitled to receive under income maintenance. France has no such penalty provision in its unemployment program. Moreover, French workers who, of their own volition, seek retraining assistance while unemployed, must be prepared to forgo income-maintenance benefits and accept up to only 120 percent of the minimum wage. Clearly, the disparity between retraining-benefit levels under the French and West German schemes produces entirely different incentive effects. Under the French scheme, the unemployed worker suffers financial penalties from engaging in retraining; as a consequence, he or she will most likely gravitate toward adjustment-retarding income maintenance. Conversely, the unemployed worker in West Germany is penalized for *not*

enrolling in retraining schemes; she or he faces a strong incentive to acquire skills that will lead to new employment.

The general unemployment program in West Germany also makes special assistance available to workers suffering layoffs from cyclically depressed industries. This assistance is extended under a short-time allowance program. The value in developing separate policies to dispense aid to unemployed workers in structurally and cyclically depressed industries turns mainly on the need to maintain purity of objectives under either scheme. Under a scheme tailored to the needs of unemployed workers from cyclically depressed industries, the principal objective should be to provide workers with short-term income maintenance at least cost. By contrast, unemployed workers from structurally depressed industries may require extensive retraining and relocation benefits before they can find alternative employment. To assist both groups of unemployed workers through one program increases the danger that cyclically depressed workers will receive costly retraining that they do not need, or that workers from structurally depressed industries with highly specific skills will not qualify to receive skill retraining. This problem has arisen under Canadian, British and American labour-adjustment schemes.

One last feature of the West German adjustment scheme is worth noting: the federal government has set up a mechanism similar to the Canadian Occupational Projection System, to forecast those job areas where training programs should be focussed. This agency attempts to ensure that unemployed workers will be trained in skills for which there will be a demand when training is concluded.

Cross-Country Policy Evaluation/Comparison

In Tables 9-2 to 9-12, the evidence furnished in the body of this study is summarized. The tables illustrate briefly the policies that have been adopted to deal with industrial decline, the amount of money (in nominal dollars) allocated to, or expended under, the various policies, and the adjustment effect of these policies. The adjustment effect was determined in accordance with the criteria set out in the first part of this section.

The tables generated for Canada are more comprehensive than those tables used to summarize foreign-policy initiatives. Table 9-2 provides an extensive outline of the general programs employed in Canada to deal with the problems posed by decline. Tables 9-3 to 9-6 examine the policies developed by specific sectors. In Tables 9-7 to 9-12, this exercise is repeated for the six other countries studied. Using the data presented in Tables 9-2 to 9-12, we summarize in Table 9-13 the frequency with which certain policies are implemented and the adjustment effect of

TABLE 9-2 General Canadian Adjustment Schemes

Scheme & Description of Assistance	Eligibility Requirements	Number of Firms/ Workers Assisted ^a	Program Expenditure	Adjustment Effect
Unemployment Insurance				
Short-term income replacement; benefits at 60% of workers average insurable earnings for up to 50 weeks.	10-14 weeks employment. Must register with Canada Employment Centre.	1,247,966 workers per month in 1983	\$10.2 billion (1983)	Negative to weak-positive
Canada Manpower Consultative Service (CMCS)				
Coordinates adjustment, extends mobility allowances; subsidizes research on adjustment strategies.			\$4.3 million (1982)	
Canada Employment Centre (CEC)				
Job placement	Workers receiving UI must register with CEC.			Weak-positive (only 18% of job seekers registered with CEC obtain this assistance)

Training Programs

1) *Canada Manpower Training Program (CMTP)*

In force until passage of National Training Act (1982).

i) Institutional-Based Training Program

Course and living allowances for 52 weeks.

219,494 workers
(1981-82)

\$692.1 million
(1981-82)

Moderate-
positive

ii) Canada Manpower Industrial Training Program

Employer based training program; 40-100% subsidy on training cost to employers.

67,746 workers
(1981-82)

\$110 million
(1981-82)

Moderate-
positive

iii) Critical Trade Skills Training Initiative (CTST)

50% wage subsidy and total training costs for duration of training.

For workers in highly skilled blue collar occupations that experience labour shortages.

5,486 workers

\$26.7 million
(1981-82)

Moderate-
positive

Moderate-
positive

TABLE 9-2 (cont'd)

Scheme & Description of Assistance	Eligibility Requirements	Number of Firms/ Workers Assisted ^a	Program Expenditure	Adjustment Effect
2) <i>National Training Act</i> (1982)				
Emphasis on training for occupations in demand. Subsumes pre-1982 scheme, but extends CTST assistance duration to 2 years; new system of labour market information gathering devised; Canadian Occupational Projection System; reduced apprenticeship grants.			\$108 million allocated	Moderate-positive
Canada Manpower Mobility Program				
Mobility assistance via exploratory assistance and subsidized moving expenses.	Relocation assistance to unemployed workers, underemployed workers and workers anticipating unemployment. Required to show work in community not available and moving to nearest community for suitable position.	35,658 assistances (1981-82)	\$10.8 million (64% of funds directed to permanent relocation)	Moderate- to strong-positive

i) *Labour Adjustment Assistance*

Consists of increased training allowances under NITP; increased levels of income maintenance; portable wage subsidies introduced; three-fold increase in mobility allowance; temporary employment program (for unemployed) and pre-retirement benefits.

Worker must be in a designated sector and community; for pre-retirement benefits must show unemployment attributable to import competition or structural change.

18,650 workers eligible from 1981-83; community employment program: 2,534 industrial training 1,363; wage subsidy 175 and mobility allowances 108.

ii) *Industrial Assistance*

Up to 75% of consultative costs to increase exports, restructure operations; pursue mergers; and perform operational analysis repayable interest-free contributions of up to 50% of capital cost of projects. Under UTST, 100% of trainee costs covered.

TABLE 9-2 (cont'd)

Scheme & Description of Assistance	Eligibility Requirements	Number of Firms/ Workers Assisted ^a	Program Expenditure	Adjustment Effect
Industrial and Regional Development Program (IRDP)				
Subsumes EDP; object: to make Canadian industry more competitive; assistance to firms through grants, repayable loans; anticipating loans and loan guarantees. Assistance level based on regional need.	Available to all Canadian firms; based on: incrementality (i.e. project not supported unless likely to proceed in location, scope and timing without support); and significant net economic benefits to Canada.		\$2.5 million allocated for 2 years	
Enterprise Development Program (EDP)				
Designed to: foster innovation in design and development of new and improved productivity; and assist adjustment to changing competitive circumstances.	Criteria: lender of last resort; and firms suffer significant burden without assistance.	381 projects	\$302.1 million in adjustment assistance (1980-81 to 1982-83)	Negative: poor monitoring; wide discretion; vague responsibility
Loan/loans guarantees for adjustment.				

Industry and Labour Adjustment Program (ILAP) (1980)

To promote industry restructuring and manpower training in particular areas of needs.

Communities designated on the basis of size of industry/sector layoff and effect as a proportion of community's workforce. Focus on effect, not cause, of dislocated labour.

\$450 million allocated for period 1980-84

Moderate-positive: low utilization because of poor information and only a few communities designated.

Portable Wage Subsidy Program

2,037 vouchers issued
236 vouchers used

\$981,900 committed (April 1, 1982 to September 30, 1984)

Job Creation Program

460 projects to generate 3,640 jobs

\$21.26 million (April 1, 1981 to Sept. 20, 1984)

Enhanced Mobility Allowances

Temporary Relocation-
Permanent Relocation

27
310

\$12,800
\$556,400 (April 1, 1981 to Sept. 30, 1984)

TABLE 9-2 (cont'd)

Scheme & Description of Assistance	Eligibility Requirements	Number of Firms/ Workers Assisted ^a	Program Expenditure	Adjustment Effect
<i>Enhanced Training Allowances</i>		2,117 Trainee starts	\$3.136 million (April 1, 1981 to Sept. 30, 1984) \$6.75 million committed	
<i>Training Incentive Allowances for Apprentices</i>		2,673	\$780,000 (April 1, 1981 to Sept. 30, 1984)	
<i>Critical Trade Skills Training</i>		3,243	\$11.7 million (April 1, 1981 to Sept. 30, 1984)	
<i>Non CEIL Adjustment Components of ILAP</i>				
Labour Canada Labour Adjustments Benefits Programs		1,315 applications approved; 2,340 applications received	\$6.65 million (April 1, 1981 to Sept. 30, 1984)	
IT&C Community-Based Industrial Adjustment Program		228 projects approved to generate 7,794 jobs	\$86.35 million (April 1, 1981 to Sept. 30, 1984)	
ITBC Industry Specific Industrial Adjustment Program		64 projects approved to create 6,577 jobs	\$57.72 million (April 1, 1981 to Sept. 30, 1984)	

Sources: Correspondence from Tricianne Burke-Smith, Manager, Assessment and Special Policy Projects, Industrial Expansion to John Whalley, February 10, 1984; Industry and Labour Adjustment Program CLAD Status Report on CEIL Labour Adjustment Components Designated Community (April 1, 1981 to September 30, 1984).

a. Unless otherwise noted, the number of firms or workers assisted is calculated for the same period as the program expenditure.

TABLE 9-3 Canada: Automotive Sector

Instrument	Expenditure	Adjustment Effect
1) Trade Protection		
i) <i>VERs</i>		Negative
2) Firm-Specific Assistance		
i) <i>Adjustment Assistance Board</i> Low-interest loans to automotive producers with a reasonable prospect of profitable operations, but unable to obtain financing.	\$83 million From 1977-83; \$105 million, of which \$40 million to Ford and 30 million to Deutz	Negative to weak-positive
ii) <i>Enterprise Development Program</i> Grants/loan assistance for high-risk projects which increase competitive efficiency.		
iii) <i>Industrial and Regional Development Program</i>		
3) Labour Assistance		
i) <i>Transitional Assistance Benefit Program</i> Income maintenance for employees dislocated because of restructuring occasioned by Auto-pact.		Negative
ii) <i>Industry and Labour Adjustment Program</i> Generous labour benefits (see Canadian General Policies) for automotive parts manufacturers.	\$35 million in assistance for industry	Weak-positive (poor utilization, no provision for retraining or mobility allowances) Weak-negative

TABLE 9-4 Canada: Cape Breton Coal Industry

Instrument	Expenditure	Adjustment Effect
Sectoral Assistance Schemes		
DEVCO		
1) <i>Coal Industry Assistance</i>		
Phase (1) (1968-73) Reductions in production achieved via extension of pre-retirement leave benefits; freeze on new hiring; and for productivity increases and opening of new mines.	\$751 million (1968-83) (capital expenditures, operating losses)	Positive
Phase (2) (1973 - present) Output-expansion assistance; modernization plans; two new mines opened.		Negative
2) <i>Industrial Development Assistance</i>		
Objectives to provide employment and broaden the economic base to attract secondary industry.	\$106 million (1968-83)	Weak-positive
Phase (1) (1968-73) Grants loans, loan guarantees and equity offered to attract branch plants to region.		Poor job-creation effects
Phase (2) (1973-77) Develop Cape Breton's resources; through loans, loan guarantees, equity, based on indirect/direct income-raising effects on any project.		
Phase (3) (1977-79) Similar to phase 2, with less active role for DEVCO.		
Phase (4) (1979-current) Priority to secondary industry assistance.		

TABLE 9-5 Canada: Shipbuilding Industry

Instrument	Expenditure	Adjustment Effect
Trade Protection		
Tariffs; 25% for coastal trade ships with exclusion for ships from Commonwealth; 15–25% for non-coastal trade use.	1) Economic Welfare Loss (1978): \$43.3 million	Negative
Sectoral Schemes		
i) <i>Construction subsidy</i> for ships built in Canadian yards. Previously as high as 40% of value of ship (1963). Under Shipbuilding Industry Assistance Program (SIAP) subsidy stands at 9%. Also under SIAP, Productivity Improvement Grants equal to 50% of cost of facilities upgrading.	\$54.6 million 1977–78 2) Total Subsidies 1978–84 amounted to \$483.3 million (510 projects)	Negative
ii) <i>Government procurement</i>	81% of total industry output (1983)	Negative
iii) <i>Subsidized financing for foreign purchases</i> Through insurance of export credit for 5 years and direct loans beyond 5 years.		Negative

Sources: 1) Hazledine, "The Costs of Protecting Jobs in 100 Canadian Manufacturing Industries," paper prepared for the Task Force on Labour Market Development (Ottawa, 1981), p. 6.

2) Data provided by SIAP.

TABLE 9-6 Canada Textile, Clothing and Footwear Sector

Instrument	Expenditure	Adjustment Effect
1) Trade Protection		
Under Multi-fibre Agreements, quotas imposed and voluntary export restraint agreements negotiated (textiles and clothing) Global quotas (footwear).	<i>Subsidy Equivalent: (1979)</i> 1) \$467.4 million for Clothing 2) <i>Economic Welfare Losses (1978)</i> Clothing : \$137.6 million; Textiles : \$98.9 million; Footwear: \$16.3 million	Negative
2) Sectoral Policy		
<i>Canadian Textile Policy (1970)</i> Objective: to assist industry to move to viable lines of production on competitive basis. Originally expected program would offer closure compensation, merger aid and restructuring assistance, but actual focus on recommending quota protection.		Negative
<i>Footwear and Tanning Industry Adjustment Program (1974)</i>		
<i>Adjustment Assistance Benefits Program</i> Offers income maintenance and pre-retirement benefits to labour under textiles policy Available if laid-off workers meet requirements.		
<i>Canadian Industrial Renewal Program (1981)</i> Assist textiles and clothing industry to restructure, consolidate and modernize production.	3) \$156.7 million disbursed to assist 208 projects for a total cost of \$784.75 million	

i) Sector Firms Program	Competitive firms on basis of 3–5 year plans; assistance conditioned on 75% of after tax profits to restructuring.	4) \$183.7 million committed (1981–84)	Moderate-positive (strict eligibility criteria, more benefits not widely available)
ii) Business and Industrial Development Programs	Assistance to consolidate/diversify economic base of areas heavily dependent on textiles, clothing and footwear activity.	5) \$241.45 million committed (to Oct. 31, 1984) to create 3,870 jobs.	
iii) Labour Adjustment Benefit Program	Subsumes AAB and incorporated in ILAP. Assistance to older employees laid off because of import competition or industrial restructuring related to government policy. Enriched mobility and training assistance, portable wage subsidy and retirement benefits.	6) \$35.24 million (1981–84)	
3) Firm-Specific Assistance	<i>General Adjustment Assistance Program</i> (GAAP) <i>Enterprise Development Program</i> (EDP) Assistance to firms to restructure operations so as to become more competitive. Assistance through: direct government loans, loan insurance and grants for consultancy services.		Weak-positive

TABLE 9-6 (cont'd)

Instrument	Expenditure	Adjustment Effect
<i>Program to Enhance Productivity (PEP)</i> 50% grant of cost of feasibility studies related to significant improvements in company's productivity.	50% of assistance directed to textiles: \$2.89 million (1973-74 to 1978-79)	
<i>DREE Assistance</i> One-fifth of capital costs for modernization/expansion, up to one-quarter of cost of new facilities, product expansion; and \$5,000 per employee.	1968-76 \$5.2 million in investment grants to industry	

- Sources: 1) Glenn P. Jenkins, *Costs and Consequences of the New Protectionism*. (Ottawa: North-South Institute, 1980), p. (iv).
 2) T. Hazledine, "The Costs of Protecting Jobs in 100 Canadian Manufacturing Industries," paper prepared for the Task Force on Labour Market Development, (Ottawa, 1981), p. 6.
 3) Correspondence from Norman Moyer, Vice President, S  ctor Firms Program, Canadian Industrial Renewal Board To Michael Trebilcock, dated February 7, 1984, Table 1A.
 4) Ibid., Table 1B.
 5) Ibid., Table 2.
 6) Ibid., Table 3.

TABLE 9-7 Australia: Instruments Deployed (generally and by sector)

Instrument	Expenditure	Adjustment Effect
Structural Adjustment Act	General Policies	
Labour (income maintenance)	\$593 million	Negative
Firms (closure compensation)	\$1.3 million (April 1974–May 1977)	Weak-positive
Special Aid to Non-Metropolitan Areas	\$5.1 million	Negative
Motor Vehicles	Sectoral Policies	
<i>Tariff Protection and Quotas</i>	NA	Negative
Imports limited to 20% of domestic market		
Footwear		
<i>Tariff Protection</i>	NA	Negative
Whitegoods		
<i>Tariff Protection</i> with specified reductions in schedule	NA	Moderate-positive

NA = not available.

TABLE 9-8 France: Instruments Deployed (generally and by sector)

Instrument	Expenditure	Adjustment Effect
1) Firm Assistance	General Policies	
i) <i>Interministerial Committee for Adaptation of Industrial Structures (CIASI)</i>		Moderate
ii) <i>Interministerial Committee for Industrial Development and Support of Employment (CIDIE)</i> Small business assistance.		
iii) <i>Regional Development</i> <i>Special Fund for Industrial Adaptation (FSAD)</i> extends long-term loans at subsidized rate of interest; repayment only if prescribed level of profitability realized.		Weak
2) Labour Assistance		Negative to weak-positive
No unemployment benefits during retraining but up to 120% of minimum wage; unemployment benefits not contingent upon participation in retraining heavy "tax" on firings.		

Steel*Sectoral Assistance Schemes*

i) 1965 Steel Agreement

Subsidized loans; reduced transportation costs; labour adjustment funds contingent on promoting concentration and rationalization.

ii) Giraud Plan

2 giant holdings created and run by government-appointed management. Initially, premium on rationalization. Later, adjustment assistance to displaced labour.

Shipbuilding*Sectoral Assistance Scheme & Trade Protection*

Inflation-insurance program; export credits; construction subsidies. However, binding limitations on capacity enforced. Assistance to displaced labour.

Textiles1) *Trade Protection* (1960–75)2) *Sectoral Assistance Scheme* (1973–78)

Loans from private/state banks for restructuring; premium on increased rationalization, modernization through nurtured growth of large firms.

Weak

1968–75
FF 2.7 billion in loans

Strong-positive

Negative to-weak-positive

Negative

Moderate-positive

TABLE 9-9 West Germany: Instruments Deployed (generally and by sector)

Instrument	Expenditure	Adjustment Effect
1) General Labour-Adjustment Scheme	General Policies	
Emphasis on vocational training incentives to enhance geographic and occupational mobility	NA	Strong-positive
2) Regional Development Programs		
Assistance to regions, with safeguards against non-productive investment	NA	Moderate- to strong-positive
Steel Industry	Sectoral Policies	
1) <i>Sectoral scheme</i> : (e.g. Saar/Ruhr Regions) Negotiated plans which have promoted nationalization		Strong-positive
2) <i>Labour assistance</i> : (Saar region) Guaranteed employment during restructuring upon transfer, wages guaranteed for 5 years; assistance conditioned on workers taking alternative jobs		
Shipbuilding Industry		
1) <i>Trade Protection</i> Credit assistance to foreign purchasers; construction subsidy to German yards; subsidy to German shipping companies		Weak-negative
2) <i>Firm-Specific Assistance</i>		Negative
Coal-Mining		
<i>Combination of Trade Protection and Sectoral Assistance</i>		Negative to moderate-positive

TABLE 9-10 Japan: Instruments Deployed (generally and by sector)

Instrument	Expenditure	Adjustment Effect
General Policies		
1) Labour Adjustment		
A) <i>Employment Insurance Law</i> (1974)		
i) Retraining/wage subsidies for workers, if continued to be employed in firms in structurally depressed industries	NA	Negative to weak-positive
ii) Relocation benefits	Y6.3 hundred million (17,823 workers from 1973-75)	Moderate-positive (not widely used)
B) <i>Employment Countermeasures Law</i> (1979)	NA	Strong-positive
2) Firm Assistance		
A) <i>Structurally Depressed Industries Law</i>		
Rationalize industry through stabilization plans	NA	Strong-positive
B) <i>Law for Provisional Measures for Small and Medium Enterprises</i>		
Assistance to small firms through loans based on firm-adjustment program	NA	Moderate to strong-positive
C) <i>Regional Development Policy</i>		
Discretionary assistance to firms locating in specified regions, and to regions to encourage acceptance of new industry	NA	Moderate-negative

TABLE 9-10 (cont'd)

Instrument	Expenditure	Adjustment Effect
Textile Industry		
1) <i>Temporary Law Governing Textile Industry Equipment (1956-77): Sectoral Scheme</i>		
i) Scrapping of excess capacity by direct purchase		Moderate-positive
ii) Low interest, long-term loans for modernization, disposal of excess machinery	Y3.6 billion Y329. billion	Moderate-positive
2) <i>Temporary Law for the Structural Improvement of Textile Industries (1974): Sectoral Scheme</i>		
Encourage restructuring through vertical integration and promote knowledge intensification through extension of loans and tax incentives. Payments to firms which employ displaced workers.	NA	Weak-positive (program not widely used)
Shipbuilding Industry		
1) <i>Sectoral Scheme</i> administered by Ministry of Transport: Minimum prices established; regulation of expansion of capacity; encouragement of development of ship-scrapping industry	Y150 million in 1977 to ship scrapping	Moderate to strong-positive
2) <i>Firm-Specific Assistance: Sasebo Heavy Industries</i>		
Loans, etc. conditioned on change of management and capital injection by shareholders	NA	Weak-positive
Coal Mining Industry		
1) <i>Sectoral Scheme</i>		
Government-promoted industrial rationalization and diversification, while assistance extended to displaced employees	NA	Strong-positive

NA = not available.

TABLE 9-11 United Kingdom: Instruments Deployed (generally and by sector)

Instrument	Expenditure	Adjustment Effect
1) Firm-Specific Assistance		
a) <i>Industrial Reorganization Corporation (IRC)</i> Established to encourage private sector mergers, but acquired "lame ducks"	NA	Negative
b) <i>National Enterprise Board (NEB)</i> Established to gain profitable stake in private industry but acquired "lame ducks"	NA	Negative
c) <i>Regional Policy</i> Non-discretionary development grant is principal tool		Negative
Labour Assistance Policy		
Unconditional unemployment-benefits program (with 6 months earnings-related supplement); Temporary Employment Subsidy; Training Opportunities Scheme; Employment Transfer Scheme		Negative to weak-positive
Coal Industry		
<i>Trade Protection</i>		
Quantitative restrictions on coal imports		Negative
<i>Sectoral Firm Assistance</i>		
Plans for Coal Industry		
i) Setting of production levels; rationalization through plant closures	Subsidies and loans amount to £1.3 billion annually	Negative to weak-positive
Sectoral Policies		

TABLE 9-11 (cont'd)

Instrument	Expenditure	Adjustment Effect
ii) Unconditional subsidies to NCB		Negative
iii) Taxing of alternative fuels and subsidizing use of coal in other nationalized industries		Negative
Shipbuilding		
1) <i>Sectoral Assistance Scheme Administered by Shipbuilding Investment Board</i>	£40 million (total by 1970), and £75 million in investment grants	Negative
E.g., Upper Clyde shipbuilders created under Shipbuilding Industry Act.	£17 million from mid-1960s to 1969	Negative
2) <i>Firm-Specific Assistance</i>		
Unconditional assistance — e.g., to Govan, Commell-Laird Courtline, and Maarlant and Volf.		
Motor Vehicles		
<i>Trade Protection</i>		
Tariffs, VERs and technical restrictions	NA	Negative
<i>Firm-Specific Assistance</i>		
E.g., British Leyland	1974-77: £350 million; 1978-80: £850 million allocated but exceeded	Negative
Steel		
<i>Firm-Specific Assistance</i>		
Massive infusion of unconditional aid to BSC	1979-80, BSC lost £545 million	Negative

NA = Not available.

TABLE 9-12 United States: Instruments Deployed (generally and by sector)

Instrument	Expenditure	Adjustment Effect
Trade Act (Title II), 1974		
General Policies		
i) <i>Labour</i> : Primarily compensatory; encouraged continued employment of labour in declining industry; poor levels of mobility and retraining assistance	NA	Negative
ii) <i>Firms</i> : compensatory emphasis		Negative
Steel		
Sectoral Policies		
<i>Trade Protection</i>		
VERs; trigger price mechanism		Negative
Textiles and Footwear		
<i>Trade Protection</i>		
Quotas		Negative
Shipbuilding		
<i>Sectoral Assistance</i>		
Unconditional: subsidies; demand-side regulation; government procurement; and provision of credit		Negative

NA = not available.

TABLE 9-13 Frequency of Deployment and Adjustment Effect of Policy Instruments

	Canada	Australia	France	West Germany	Japan	United Kingdom	United States
Trade Protection Frequency	high	high	low	low	low	medium	high
Adjustment effects	negative	negative	negative	negative to weak-positive	negative	negative	negative
Regional Policy Frequency	high	low	low	medium	low	high	low
Adjustment effects	negative	negative	weak-positive	strong-positive	negative	negative	negative
Firm-Specific Frequency	medium	low	medium	low	low	high	low
Adjustment effects	negative	negative	negative	negative	weak-positive	negative	negative
Sectoral Schemes Frequency	low	low	high	medium	high	medium	low
Adjustment effects	negative	negative	negative to strong-positive	strong-positive	weak to strong-positive	negative	negative
Labour-Adjustment Schemes Frequency	low	low	low	high	medium	low	low
Adjustment effects	negative to strong-positive	negative	negative to weak-positive	strong-positive	negative to strong-positive	negative	negative to weak-positive

these policies. This table clearly reveals both the penchant of the United Kingdom for deploying adjustment-retarding instruments and the relative aversion of West Germany and Japan to such policies. In between these two poles, France's policy menu may appear as somewhat more conducive to adjustment than the policies of the remaining countries. The rank ordering of policies according to adjustment effects is almost parallel to the ordering of relative economic performance that we developed in the first section of this chapter. The only exception is France, whose performance was deemed less robust than that of Japan, West Germany and Australia from 1960 to 1971 and than that of Japan, Germany, Canada, Australia and the United States from 1972 to 1981.

Institutional and Political Framework

The preceding section concluded by comparing the relative economic success of the seven countries surveyed with the adjustment-facilitating effect of their respective industrial policy menus; this exercise revealed a strong correlation between these two variables. Admittedly, the linkage between resource-factor mobility and economic wealth is by no means novel: both economists and policy makers have long been aware of such a relationship. If, indeed, this causal relationship is valid, the question arises: Why have all of the countries studied not adopted such resource-maximizing policy menus?

To address this matter we shall examine the nature of the institutional arrangements in the seven countries. To consider the structure of these arrangements sheds light on the process by which the claims of competing interests are accommodated and reconciled. This information then allows us to understand the complexion of outcomes likely to be generated by this process.

The thesis that we shall evaluate here is that a high degree of integration in industrial policy-formulation responsibilities in public and private sector institutions is conducive to the adoption of wealth-maximizing policies. In terms of the "prisoner's dilemma" paradigm referred to earlier in this study, it may be argued that integration of institutional structures works to attenuate the incentives for strategic non-cooperative behaviour by ensuring that there are formal and regularized channels of communication linking most major players, and by internalizing to a greater extent the costs of policies that more narrowly focussed institutional structures may have a tendency to favour. This institutional feature renders the policy-making process less hospitable to relatively ad hoc interventions on behalf of narrowly defined interests. As a consequence, policy outcomes which generate net economic benefits can be implemented, even though costs may be imposed on politically salient constituencies.

In this section, we have isolated four major characteristics of institutional integration. The first two characteristics reflect the level of institutional integration in the public sector: constitutional division of powers; and the level of bureaucratic coordination, prominence and autonomy in decision making. The second set of characteristics relates to the degree of institutional integration in the private sector: the cohesiveness of producer groups; and the degree of bank-firm integration. We shall treat each of these characteristics in turn.

Constitutional Division of Powers

To check the tendency of decentralized governments to pursue “beggar-thy-neighbour policies,” a more centralized system of government as in Japan, France and several of the Scandinavian countries (which have not been reviewed in this study) may have its advantages. The United Kingdom provides an important counter-example that suggests caution in accepting this thesis too uncritically. A less radical alternative would be to develop strong intergovernmental bodies which would work to counteract this tendency; the Upper House in West Germany provides an example. It should be noted, however, that while decentralized constitutions may play a role in nurturing “riotous pluralism,” they can also be a source of creativity and innovation in policy making. Obviously, an increased number of access points to the decision-making system allows a greater diversity of views to be forwarded on any given problem.

Bureaucratic Coordination, Prominence and Autonomy in Decision Making

As with a federal division of powers, the argument that is advanced here is that a decentralized bureaucratic mode of decision making increases the number of access points to salient interest groups. When bureaucratic decision making is diffused across a number of bodies, narrowly defined interest groups are able to permeate the process and to exploit cleavages among these bodies. Policy formulation becomes subject to a process of bargaining between competing agencies and departments of government. Moreover, the activities of these governmental bodies may be beset by “clientele” effects. Consequently, policy outcomes generated by this process become un-coordinated and inconsistent. As Dyson and Wilks (1983a, p. 256) observe: “A depoliticized process of crisis management which is uncontroversial, consensual, and marked by substantial agreement about technical criteria, will tend to reinforce and stabilize the system of resource allocation.” Japan, West Germany and France exhibit high levels of bureaucratic integration; the United States, the United Kingdom, Canada and Australia exemplify less concerted bureaucratic structures.

The obvious disadvantage of excessive centralization is that the bureaucracy may become overly insulated from the political process and may come to behave as an unaccountable, wholly autonomous actor. Not only does this result undermine important democratic values, but it also increases the risk of non-marginal system-wide errors.

Cohesiveness of Producer Groups

Another strand of the institutional integration argument, which Olson (1982) and others have developed, concerns the desirability of securing the participation of highly disciplined and encompassing interest groups in the industrial policy-making process. The basis for this proposition is that cohesive, encompassing, interest groups will, by virtue of the fact that they represent national constituencies, evaluate policy from a broader perspective than will narrowly defined interest groups. This fact may lead the former groups to support policies which will confer the greatest national benefit on society even if some costs are imposed on members of their own constituency. To adopt a national perspective on policy evaluation may inhibit producer groups from championing myopic, beggar-thy-neighbour policies. West Germany and several of the Scandinavian countries are examples of countries where peak business and labour organizations are engaged with government in regularized consultative structures with major policy-formation roles. Japan and France exemplify the same phenomenon in the case of business interests, but not in that of labour interests. Canada and the United States exhibit much more fragmented private interest-group structures. In Britain and Australia, labour is relatively highly unionized, but while peak organizations exist for labour and business, these groups appear to exert limited influence over their constituent organizations.

The deficiency with the peak interest-group thesis is that in its most literal form, it becomes a prescription for an authoritarian state. In this setting, one "peak" agency, a one-party state, is able to undertake the most highly integrated analysis of policy choices. Yet this outcome is clearly inconsistent with our political values. Even less extreme forms of institutional integration, such as the permanent consultative structures of peak management and labour groups, and government leaders in West Germany, pose similar risks of lack of transparency and accountability.

Bank-Firm Integration

According to Zysman (1983, p. 76), close integration of banks and firms provides the state with the ability to "enter continuously into the industrial life of private companies and to influence their strategies the way a rival or partner would." The reason is that strong bank-firm linkages allow the state to use its influence over banks to dictate industrial policy

outcomes, particularly where, as in France and Japan, the state exerts a strong direct influence over the financial sector. Government discretion in the provision of industrial finance is a preferred tool of industrial policy because it is unencumbered by complex administrative or regulatory rules and generally operates in a de-politicized context. Thus it affords the government greater flexibility in fashioning creative solutions to the problems faced by industrial decline. Yet even where, as in West Germany, the state is not actively involved in the affairs of banks, close bank-firm integration through equity holdings and cross-directorship can serve as a conduit of advice to firms and allows banks to play an active role in anticipating destabilizing shocks to a firm's activities.

Again, a disadvantage of bank-firm integration turns on its insulation from the political process. At the extreme, governments can induce policy outcomes which cannot be politically supported in an open forum. Moreover, decreased accountability may enhance the risk of non-marginal errors in policy. Furthermore, the heavy direct involvement by banks in the industrial sector may increase risks to the stability of the financial system. Finally, the high degree of bank-firm and state integration in Japan and France and bank-firm integration in West Germany may be a reflection of weakly developed private capital markets and thus have limited applicability to the North American economy.

In Table 9-14 we summarize the salient institutional features identified above, across the countries studied. The table shows a general ranking of countries, in terms of the integration of their various public and private institutions, that is closely correlated with the ranking of countries that is generated when the mix of industrial policy instruments is evaluated on the basis of their adjustment effects. At one end of the spectrum lie the United Kingdom, Australia and Canada. In each of these countries executive autonomy is limited, the bureaucracy is only weakly integrated, interest groups are fragmented, the level of bank-firm-state integration is low, and in Australia and Canada government jurisdiction is decentralized. In contrast, the Japanese and West German governments possess extensive executive authority; in those countries the bureaucracy is closely integrated, peak interest groups are influential in policy-making processes, and close linkages exist between banks and firms. In addition, Japan has a highly centralized government. Recent empirical testing of the Olson "economic sclerosis" thesis concerning the impact on economic growth rates of the presence of narrow, as compared to encompassing, distributional coalitions also seems to provide significant support for the thesis (McCallum and Blais, 1985).

The evidence, however, also reveals some ambiguities relating to the *precise mix* of institutional components conducive to the development of such policies. For instance, while we have defined the poles of both economic performance and the adjustment effects of policy, with Japan and West Germany at one end and the United Kingdom at the other, it is

TABLE 9-14 Institutional Integration

	Canada	Australia	France	West Germany	Japan	United Kingdom	United States
Public Institutions							
Government jurisdiction	Decentralized Limited	Decentralized Limited	Centralized Extensive	Decentralized? Extensive	Centralized Extensive	Centralized Limited	Decentralized Extensive
Executive autonomy							
Bureaucratic integration	Weak	Weak	Strong	Strong	Strong	Weak	Weak
Senior civil service recruitment	Non-political	Non-political	Non-political	Non-political	Non-political	Non-political	Political
Private Institutions							
Interest groups	Fragmented	Fragmented	Fragmented	Peak Strong	Peak?	Fragmented	Fragmented
Bank-firm integration	Weak	Weak	Strong		Strong	Weak	Weak

clear that each of these countries has institutional characteristics which might undermine the ease with which adjustment-facilitating policies are implemented: Japan has virtually excluded organized labour from the decision-making process; the United Kingdom has a unitary government; and West Germany's federal structure implies a measure of decentralization. In this last respect, however, a sharper distinction is drawn than in other federal systems, such as Canada's, between policy making which tends to be heavily centralized in the national government that encompasses representatives of both national and regional interests, and policy administration which is decentralized to the states. Moreover, as McKay and Grant (1983) observe, there is a tendency among industrial policy analysts to simplify the institutional characteristics of the countries studied into excessively stylized categorizations. These authors note that "reality rarely matches the popular image of *dirigiste* French bureaucrats and rationally consensual Japanese officials." This review suggests that considerable caution should be exercised in prescribing wholesale reforms based on an "ideal mix" of institutional characteristics.

Implications for Future Canadian Adjustment Policy

Introduction

Structural adjustment is a phenomenon continuously at work in all industrialized economies. Most politico-economic systems can readily accommodate continuous marginal adjustments in the allocation of resources. Most encounter more difficulty when the adjustments confronted are less marginal in character. Nevertheless, the major Western economies have, in the past, experienced wrenching changes and managed over time to adjust to them. These changes include agricultural reform and the enclosure movements in medieval England; the Industrial Revolution in Britain in the latter part of the 18th century and first half of the 19th century, including major technological changes such as the invention of the steam engine, electricity, the telephone, the internal-combustion engine; the mass movement of people out of agriculture into urban industrialized working environments, which has occurred quite recently in several major industrialized countries such as Japan and France; and major economic and political convulsions such as the Great Depression and two world wars. While it may be that the adjustment problems facing a number of industrialized economies today, including Canada, are more severe than those that have had to be confronted in the first three decades of the postwar years, it is important to maintain some historical perspective on their likely scale and effects, and not to underestimate the adjustment capacity of a society.

During some of the major adjustments undergone in the past, such as

the agricultural reform in medieval England and the early years of the Industrial Revolution, some of the principal cost bearers were politically disenfranchised or otherwise politically powerless. With the evolution of our democratic processes of government, this has become markedly less true. Accordingly, the interaction of our political and economic systems in addressing the implications of change have become more critical and more complex when societies are evaluating adjustment-policy options that are ideally both economically well directed and politically feasible. This change accounts for the stress that this study places on the political economy of the economic adjustment process. It is an unfortunate irony that with increasing disciplinary specialization in a technically more complex society, economics and politics — and for that matter ethics — have recently evolved in intellectual isolation from each other. This development belies their early origins. (Adam Smith, for example, was Professor of Moral Philosophy at the University of Glasgow in the 18th century.) It also makes more difficult and less likely the integration of relevant policy perspectives. This integration is a necessity if the impulses of our economic and political systems are to be constructively reconciled in contemporary policy making.

A concerted and enduring public policy focus on facilitating rapid economic adjustment and easing problems of transition and concomitant adjustment costs clearly must be assigned a central role in any modern industrialized country's economic, social and political priorities. It is too easy to be trapped by the tautological claim that during recessions no adjustment is possible, while once recovery takes place, no adjustment is necessary (Courchene, 1984, p. 133). Even in times of high unemployment, some industries may be growing and suffering from lack of workers with appropriate skills. For example, a recent survey of 4,012 establishments in Canada found that approximately half of the 1,354 respondents reported hiring difficulties during 1977–1979, and 43 percent anticipated shortages during the next five years (Saunders, 1984, p. 1). Conversely, in periods of rapid economic growth and low overall unemployment, some industries may be declining, causing job displacement in areas where workers with job specific skills or facing losses associated with other locational fixities cannot readily be reabsorbed into the labour force.

In fashioning policies directed to declining sectors, a general difficulty facing policy makers who must choose appropriate policy instruments is making the initial judgment that a sector is in long-term decline. Picking losers may be no easier than picking winners.¹ The Canadian experience bears out this difficulty. Does Canada lack any comparative advantage in shipbuilding, or are the present difficulties of the industry a function of zero-sum subsidy behaviour by many foreign governments that now hopelessly obscures the nature of our comparative advantage in this sector? In other words, our industry might be internationally competi-

tive in some areas if all nations with shipbuilding industries would agree to withdraw trade-distorting subsidies. At the end of the 1960s, widely accepted opinion held that many aspects of the Cape Breton coal-mining industry were not viable and should be phased out. With the advent of the Organization of Petroleum Exporting Countries (OPEC), coal prices rose sharply, and since that time the coal-mining industry has, in fact, expanded. Coal prices have declined subsequently, but given more cautious prognoses for the future of nuclear energy and continuing uncertainty about price and supply conditions for Middle East oil, it is less easy to make confident judgments about the economic future of this industry. U.S. textile exports have grown significantly in recent years, and technological advances that substitute capital for labour suggest that at least some elements of this industry are, or could become, internationally competitive. Have automobile and farm-machinery manufacturing, two Canadian industries recently undergoing severe economic difficulties, merely faced a cyclical downturn in demand, with few long-run structural implications? Or have they lost their long-run international competitiveness? Difficult as these questions are for private sector decision makers intimately acquainted with an industry's problems and potential, they pose even more difficult decisions for public sector policy makers typically lacking familiarity with these matters and faced with special interest-group pleadings that will exploit all prevailing ambiguities to their advantage. This situation would seem to suggest that extreme caution be exercised in invoking adjustment policies that are designed to have fundamental long-run structural effects on sectors that can only be defended by reference to highly debatable and uncertain premises. Rather, decision makers should prefer policies that minimize the risk of these major systematic errors in judgment. They should look to increase flexibility, adaptability and reversibility on a number of smaller margins, where decentralized judgments by various affected economic agents concerning an industry's future prospects dominate centralized public sector judgments.

In Chapter I of this study, it was argued that political forces would tend to invert policy prescriptions proposed by both economic and ethical frameworks of analysis. The result would be the adoption of policies that first favour trade protection to preserve output and employment, then favour subsidies to firms to maintain output and employment, and finally favour subsidies to labour to facilitate mobility. It is assumed in this chapter that short of a radical re-ordering of the political system that generates these policy impulses, feasible alternatives to present policies entail marginal changes in the policy mix. The purpose of these changes would be to reduce the degree of incongruence between those policy outcomes dictated by good politics and those dictated by good economics and good ethics. We now turn to an examination of these policy alternatives.

Trade Policy

The substantial political attractions of trade protection mean that despite its economic costs and the retardation of the adjustment process that it entails, it is unrealistic to propose the complete abandonment of trade-protection instruments in import-affected sectors. Some form of protection is likely to be maintained, though falling global tariffs, sanctioned by multilateral treaty obligations, increasingly render extensive, long-term, import-substitution policies a tenuous option as a central ingredient of this country's industrial policies.²

Where trade-protection instruments are still available to the Canadian government, the next most effective policy options to abandonment, either unilaterally or in trade negotiations, might be simply to hold a tariff constant over time. This strategy would induce more orderly and less disruptive contraction as foreign competitors' costs fell and imports increasingly overrode the tariff barriers and progressively eroded the market shares of domestic industries. Alternatively, as with the last round of multilateral trade negotiations, gently phased-in tariff reductions might mitigate the costs of adjustment, while allowing the gains to be realized over time (albeit with some reduction as a result of the more protracted transition). The worst possible strategy for deflecting adjustment processes is the introduction of long-term quotas, implying guaranteed market shares for domestic producers. Unfortunately, however, in sectors under severe import pressure, a policy of benign passivity is unlikely to be politically sustainable; demands are likely to be made for unilateral escape clause or safeguard action, anti-dumping duties or bilateral "voluntary" export restraints induced by implicit threats of unilateral action. These escape hatches available to domestic governments to countervail international trade commitments have been used more frequently both in Canada and elsewhere in recent years, and they retard needed adjustments.³ Containing their deployment seems an important priority. One line of policy development might be an attempt to secure more tightly defined international agreements on their availability, perhaps by requiring that as a condition of their use domestic governments simultaneously develop an approved adjustment strategy for the affected sectors, to provide for reduction of capacity and industry restructuring. Another line of policy development might be to implement institutional structures that improve information flows to the public about the expected costs and benefits of trade protection, and information flows to policy makers about the reactions of affected constituencies. While we are not advocating taking politics out of government, an expanded mandate for a general body like the Tariff Board that provides that governments may not implement changes in effective levels of trade protection by such means as safeguard measures and "voluntary" restraints (in Canada, now, effected simply by Cabinet Order-in-Council)

without first remitting the matter to the Tariff Board for evaluation. That board's duty would be to conduct an investigation, hold public hearings, and submit a full public report assessing costs and benefits of the proposed action, and to consider alternative non-trade protection-adjustment policies that might be preferable. The government would be free to accept, reject or modify these recommendations, but against a political back-drop of an extensive public inquiry and published findings and recommendations. It is vital that the agency given this mandate have a general economic focus (like that of the Tariff Board) and not a specialized industrial mission (like that of the Textile and Clothing Board) if "clientele" affects are to be mitigated.⁴ The United States International Trade Commission and the Australian Industry Assistance Commission embody some of the foregoing institutional characteristics. To offset producer pressures for protection, the subsidization of consumer interest-group participation in proceedings of such a board would seem to be a desirable additional institutional feature.⁵ More generally, further reforms of campaign- and party-financing laws designed to reduce the dependence of political parties on financial contributions from concentrated producer interests would seem to promote the same end. In short, changing (if only marginally) the political dynamics surrounding protectionist policies by reducing information and participation costs for major, but thinly spread, cost bearers and by reducing political dependence on the resources of producer interests might increase the political costs of implementing such policies.

Firm Subsidies

If the deployment of trade-protection instruments is more tightly constrained by laws and made politically less expedient or more costly by heightening the visibility of pertinent decisions, politicians are likely to face political pressures to substitute the next most politically attractive instrument for preserving industry output and employment, that is, firm-directed subsidies. Again, these means undermine, or at least attenuate, the adjustment process. From an economic perspective they entail most of the same economic costs as a tariff (a subsidy can always be devised to replicate the effects of a tariff), and in well-functioning capital markets there are few convincing market-failure arguments that justify the granting of industrial subsidies to declining sectors. One of the more seductive arguments is that state assistance to facilitate capital modernization may be necessary to make an industry internationally competitive. But Harris, Lewis, and Purvis (1984) make the telling point that obsolete plant is often the result, not the cause, of loss of international competitiveness. Firms which are able to cover only variable costs are constrained to allow their fixed assets to run down and, with them, their long-term capacity. If an adequate return could be made on new fixed

assets, presumably the capital market would provide the funds required to make this investment. A government judgment that such an investment will yield long-run competitiveness and profitability will typically be at variance with this private capital market judgment and should, for this reason, be viewed with considerable circumspection.

Even in job-maintenance terms, industrial subsidies are suspect. As Dan Usher (1981) argues, for such a relationship to hold it is necessary to assume that a subsidy has created jobs marginal to the recipient firm (that is, jobs that the firm would not have created in the absence of the subsidy). Even if this is true, a firm-specific subsidy will not increase employment in the industry of which it is part unless the jobs are marginal to the industry (that is to say, without the subsidy, other firms in the industry would not have increased their output and employment to absorb the share of the failing firm). Even if the subsidy creates jobs that are both marginal to the firm and marginal to the industry, are they marginal to the economy at large? Subsidies, by definition, have to be withdrawn from resources that would otherwise be employed elsewhere in the economy, and there is no reason to assume that the net employment effects of a subsidy will, in fact, be positive, even though the political visibility of the benefits may be greater than the political visibility of the costs. Moreover, firm-specific subsidies to troubled firms in declining sectors often tend to preserve the most marginal and least efficient firms in the industry; here, job maintenance is directly antithetical to efficient restructuring.

If, nevertheless, political pressures dictate firm-directed subsidies in declining sectors, subsidies to assist the strongest, not the weakest, firms would seem a superior strategy. This policy, for example, would underwrite some of the costs associated with mergers, consolidations, orderly reduction of physical capacity, and so on. Recent bail-outs of failing firms in Canada have missed such opportunities. Three separate farm-machinery companies in financial distress, Massey-Ferguson, Cooperative Implements and White Farm, have received substantial aid from the federal government, despite serious excess capacity at the firm and industry levels. No attempts at facilitating mergers and capacity rationalization seem to have been made. A major trucking company, Maislin Trucking, was bailed out (but ultimately failed), despite excess capacity in the industry and despite possibilities of inducing a merger with other long-haul carriers with similar route networks. The bail-out of the Atlantic fish-processing companies, while industry wide in its focus, still promoted the maintenance of inefficient branch processing plants.⁶

As we pointed out in Chapter 1, the economic arguments for government subsidies to firms, to induce rationalization or exit from a sector, are generally not compelling. If one takes as given, however, that firm-directed subsidies are politically unavoidable, the absence of conditions on assistance to induce efficient contraction and rationalization may

entail substantial problems: Which firms should be subsidized and for how long? Moreover, subsidization may substantially increase a government's political vulnerability to subsequent demands for subsidies. The political costs either of appearing to acknowledge an initial mistake when terminating a stream of assistance or of being perceived as the agent primarily responsible for social fall-outs of firm failure if support is terminated may expose the government to opportunism on a severe scale. In other words, it seems imperative that if support is to be provided, it take a form that minimizes the prospects of recurrent demands for assistance through insisting on (orderly) contraction and rationalization as terms of the initial grant of assistance.

One danger of the proposed policy focus, as we noted earlier, is that the government may make an erroneous judgment about the future of an industry and induce major structural changes in the industry based on that judgment. This danger might be reduced by leaving the initiative for devising restructuring proposals, within the policy framework suggested, with the industry in question (as in Japan), rather than imposing on it a centrally conceived blueprint. Moreover, as the U.K. and, to a lesser extent, the French experience indicate, to induce mergers and consolidations without also inducing reductions in capacity and enhanced residual productivity courts the danger of assembling elaborate corporate umbrellas that shelter the perpetuation of inefficient multi-branch operations which may continue to demand subsidies. Orderly contraction and the reinforcement of points of strength in the industry, viewed as a whole, become the focus of policy, not government-financed operating subsidies or modernization programs that attempt to maintain existing industry capacity. The use of a buffer body, such as the Canadian Industrial Renewal Board, to implement policies with this industry-wide focus may allow politicians to "distance" themselves from political interests which demand other forms of subsidy. This step might reduce the risks of an erosion of the policy objectives, although "clientele" effects with a specialized industry board involve significant countervailing risks that an initial mandate, framed as proposed, will be perverted over time. (The history of the Cape Breton Development Corporation, it might be argued, provides such an illustration.)

A further policy refinement would be to discourage the use of low-visibility subsidy instruments: tighter GATT Non-Tariff Barrier Code on Government Procurement and Subsidies; compelling the costing of off-budget subsidies such as loan guarantees and loans at below-market interest rates, and inclusion of these costs in government-expenditure budgets and spending envelopes at the time that the assistance is provided in order to increase visibility and accountability.⁷ Again, at a more general level, it may be important to reform campaign-financing laws so as to reduce further political dependence on the financial resources of concentrated producer interests.

Labour-Adjustment Policies

If these policy shifts were feasible, political attention would necessarily be directed to a greater extent to addressing the adjustment costs faced by labour. It is here that both economic and ethical frameworks of analysis suggest that the focus should be placed. At this point, two tiers of proposals might be contemplated. The first tier would address adjustment costs faced by unemployed workers generally and provide much more generous assistance to individuals undertaking institutional and on-the-job training and more generous relocation allowances. In financing this increased policy emphasis on training, retraining and mobility, it would seem desirable to consider, as in West Germany and Japan, making receipt of unemployment benefits conditional on participation in a retraining program after an abridged period (perhaps 16 weeks) of unconditional benefits. The presumption would be that unsuccessful job search for this period of time implies a need for different or up-graded skills. Thus, a significant portion of the Unemployment Insurance Commission's (UIC) expenditures would be redirected to underwriting part of the costs of job retraining. While it might be argued that either unconditional lump-sum and/or periodic payments to displaced workers would allow them to make decisions about future employment options or retraining in the light of the best labour-market information that can be made available, it was pointed out in Chapter 1 that the social costs of unemployment are not fully internalized to the workers, at least those receiving periodic payments. For those receiving lump-sum payments, a serious moral hazard arises where the lump sum has been expended without requirements for retraining, relocation or re-employment, and governments face politically difficult decisions about whether to deny further forms of assistance. As with firm-specific subsidies, it seems imperative that assistance be conditioned on the recipient adopting some course of action that minimizes prospects of recurrent demands for relief.

In terms of improving existing Canadian retraining policies, which appear to have been of only limited effectiveness, Saunders makes a number of useful suggestions (Saunders, 1984). First, Canada Employment Centres, maintained by the federal Department of Employment and Immigration, have highly incomplete information about job vacancies across the country; they are consequently limited in their ability to match workers facing layoffs with jobs in other sectors. By way of responding to imperfect information about labour markets, Saunders proposes that employers, or at least larger employers, be required to register all job vacancies with Canada Employment Centres. If this requirement is viewed as imposing excessive costs on employers, Canada Employment Centres might collectively be charged with the responsibility of maintaining an up-to-date information bank of all job

vacancies advertised anywhere in Canada. More disaggregated and more regular Labour Force Survey data for specific occupations, as well as more systematic medium-term forecasting of skill shortages, would enable better matching of workers facing the prospect of layoffs with institutional or on-the-job retraining programs that are responsive to those shortages.

Secondly, as noted in Chapter 1, there has been criticism of existing institutional retraining programs that purport to respond to market failures in the investment in human capital. These programs are often too short to provide significant higher skills training; too few places for qualified and interested candidates are available; living allowances for trainees are inadequate, and student loans are not applicable; federal-provincial financing arrangements give a largely exclusive right of participation to provincial educational institutions and generally exclude private sector training institutions, thus precluding more diversified judgments about future employment opportunities.

Thirdly, geographic mobility assistance presently covers only part of the direct costs of a move and provides insufficient assistance in advance of the move. Again, effective mobility-assistance grants are responsive to information imperfections in labour markets and difficulties of borrowing against human capital.

Fourthly, early retirement schemes for older workers (including enriched UIC benefits for workers between the ages of 60 and 65), while presently available in the textile, clothing, footwear and tanning industries, may warrant more general consideration (as in France), to increase on-the-job training and employment opportunities for younger and potentially more productive workers.

Fifthly, wage subsidies presently payable to employers who agree to provide on-the-job training to employees, including those previously unemployed, should probably be varied counter-cyclically to provide adequate incentives to participate in such programs. An extension of the wage-subsidy concept might encourage the provision of portable wage subsidies of limited duration (perhaps for two years) to unemployed workers; these subsidies might be conditional on receipt of on-the-job training from employers. In this way, expanding sectors are assisted at the same time as the exit of resources from contracting sectors is encouraged. At present, institutional retraining programs dominate on-the-job retraining schemes. It may well be that this policy emphasis should be reversed, in part, again, to diversify judgments about future employment opportunities and in part to provide greater opportunities for practical job experience.

Finally, the lack of portability of private pension-plan entitlements, in cases where the employer's contributions have not vested, may be a significant deterrent to job mobility and may justify concerted federal-provincial action to develop uniform and more permissive rules on

vesting. It must be acknowledged, however, that more portable pensions create some tension with a firm's incentives to provide general on-the-job training if returns on such investments cannot be fully captured by the firm. Public subsidies for some firms that provide on-the-job training may partly offset these disincentive effects.

All of these policies are designed to facilitate the redeployment of human capital from declining to expanding sectors by easing the transition costs involved in such shifts. In this respect, they stand in contrast to general unemployment-insurance programs or sector-specific extended unemployment-benefits policies (such as those obtaining under Canada's textile-adjustment programs or the United States Trade Adjustment Assistance program), many of which appear to retard, rather than promote, the adjustment process.

The net effect of these proposals would be to integrate social policy much more fully with economic policy. Japanese, West German and, to a lesser extent, French experience all suggest that this integration is pivotal to an effective adjustment strategy. Politically, it is difficult to see insuperable impediments to these shifts in policy. The costs as well as the benefits are likely to be widely dispersed, and if retraining is linked to receipt of unemployment benefits, budgetary implications are reduced, while reassurance is provided to cost bearers that these expenditures are not simply welfare under another name.

This first tier of proposals is general in nature and is directed to all unemployed workers. The proposals do not, however, address the large private costs that may be incurred by workers and related interests dependent on declining industries in depressed communities. As suggested in Chapter 1, these costs may be quite substantial and may have expenditure implications that are politically unattractive, given the availability of other instruments (trade protection, industrial subsidies) that attenuate or conceal the costs of assistance, as well as the gains from rapid industrial adjustment. Here political and economic considerations might best be reconciled by focussing public resources on communities where the economic costs of adjustment are likely to be highest and where, consequently, the political costs of not intervening in the adjustment process are also likely to be highest. In the second tier of proposals, those communities would be designated for special assistance where the policy goal would be to facilitate adjustment by generously subsidizing exit costs. In these communities, in addition to the first tier of proposals, generous severance packages for older workers, compensation for loss of resale value on houses and loss of social amenities, and compensation to the residual elements of the community to offset higher per capita public services (through assistance to municipalities) would also seem to be requirements, principally for political, but to some extent, for ethical reasons, even though economic rationales for intervention may not directly justify such policies.

Under these proposals, by concentrating resources on severely distressed communities to induce members to forgo the "stay" option and exercise the "exit" option, the budgetary implications can be contained. The Industry and Labour Adjustment Program (ILAP), recently terminated, possessed some of these features. Under this program, ten communities and two industrial sectors were designated "distressed." However, the program was temporary in nature, was modestly financed, and focussed excessively, through modernization subsidies, on providing financial assistance to firms to stay or to relocate in designated communities rather than on adjustment assistance to individuals; in offering individuals assistance, it focussed excessively on attempting to create mostly temporary employment opportunities in the existing communities. In short, the program appeared to embrace and confuse both cyclical and structural concerns. Although it exhibited serious shortcomings, it suggests the beginnings of productive new policy directions.

It is of paramount importance that such a program be permanent in nature. To adopt structural adjustment policies only in recessions, when alternative resource-deployment options are severely constrained, is likely to be much less effective and more costly than it would be to adopt adjustment policies directed to declining sectors in a generally more buoyant economic environment. Focussing on problems of adjustment at the bottom of the business cycle is much less constructive than it would be to address them at other points in the business cycle. Recent preoccupation with, and popular writing about, problems of structural adjustment in North America, while responsive to political currents of concern in a deep recessionary environment, reflects this distorted policy focus. By way of contrast, the Japanese *Structurally Depressed Industries Law* is a prominent example of the recognition of the need for a longer-term perspective on facilitating adjustment in declining sectors. It is acknowledged, of course, that a single focus on labour-adjustment policies in a period of low economic growth and high unemployment is unlikely to prove politically acceptable or even economically very effective; hence, one would expect to observe pressures for continued reliance, in this environment, on trade protection and on industrial subsidies to preserve existing jobs. But even acknowledgment of the difficulties of fashioning effective adjustment strategies in a recession should not be allowed to obscure the fact that these adjustment-retarding policies have also been employed in declining sectors in Canada in much more buoyant times, when difficulties of adjustment were much less acute. Neither should it be allowed to obscure the importance of re-ordering our adjustment responses in the future as a stronger economy mitigates these difficulties.

A major potential problem with these second-tier labour-adjustment proposals is one common to the other policy instruments already reviewed (trade protection and industrial subsidies): that is, that they are

based on government judgments that communities or sectors are in long-term decline. If three years ago, for example, the automobile industry and communities like Windsor had been designated as distressed, and if a major exodus of labour had been induced by the foregoing policies, this development would appear in retrospect to have been a serious mistake, at least at the present point in time. This, of course, suggests that extreme caution should be used in implementing radical exit-oriented policies on the basis of short-run evidence of industrial difficulties. Even with such caution, however, mistakes may still be made, but what differentiates these labour-adjustment policies from either trade protection or industrial subsidies is that the risks of error are much more widely diversified in the sense that individual workers are free to accept or reject assistance as they see fit, in the light of their own judgments of future industry prospects and their own willingness to accept wage concessions or profit- and risk-sharing remuneration arrangements that reduce real wages to levels closer to opportunity costs. If they elect to accept assistance and to relocate, new employment decisions will be diversified across the economy, and these are unlikely to prove systematically misconceived as trade protection or industrial subsidy policies may prove to be. Adjunct policies that attempt to "hot-house" new industries into depressed communities run the added danger — amply borne out by Canadian experience relating, for instance, to Labrador Linerboard, Deuterium, Clairtone, Bricklin, Churchill Forest Products — of attempting to save losers by picking winners. Moreover reversibility as it applies to these industry-oriented and regional policies is often politically constrained because of continuing and concentrated community dependencies. This outcome is unlike the dispersed consequences of mistaken labour-adjustment policies and the low political costs of market-led reversibility. This is an extremely important dynamic consideration in the choice of adjustment strategies.

Institutional Reform

To import institutional structures that seem to exhibit desirable economic properties in their home context would seem a highly speculative exercise in terms of likely effects in the recipient country. In any event, such action would probably face strong political resistance from incumbents in existing structures threatened with displacement or depreciation. Nevertheless, comparative experience may offer some simple lessons that are relevant to the economic policy-making process in Canada in better concerting industrial policies. This experience, while far from consistent in these respects, suggests that strong peak or encompassing interest groups in the private sector, principally business and labour, may be more likely to internalize more fully the costs and benefits of proposed policies than are narrow special interest groups; and

that a central government with a strong and organizationally well-integrated and closely concerted industrial policy role, and an expert and semi-autonomous bureaucracy with major responsibilities for industrial policy formation and implementation may be important institutional strengths.⁸ On the other hand, problems of political accountability with strong centralized private sector interest groups and a powerful semi-autonomous bureaucracy, and the risk of serious systemic error in policy in a highly integrated policy-making process also suggest that there are dangers in unqualified acceptance of these propositions. Rather, marginal or more measured changes in institutional structures that are responsive to the most dysfunctional features of present arrangements may be more realistic policy options.

Diffusion of responsibilities for policy making and implementation within the Canadian federal government, across numerous departments and agencies with different roles in the industrial policy fields, differs sharply from much more concerted decision-making structures evident in Japan, West Germany and France. Whether centralization within a more tightly defined departmental structure, as in Japan, or stronger central direction and coordination through high-level inter-ministerial committees, as in France, would be more responsive to this deficiency is not clear. When to the diffusion of focus within the federal government is added the diffusion of responsibility in the industrial policy field between the federal and provincial governments, which often diffuse responsibility further within their own structures, government policy making almost necessarily becomes *ad hoc*, reactive, and inconsistent. In these circumstances special interest groups are able to pursue numerous avenues to government influence, enlisting "clientele" institutions of government at either level in their support (Jenkin, 1983; Thorburn, 1984).

With respect to federal-provincial relations, apart from ambitious and perhaps unattainable agendas of reform, such as fundamental reform of the Senate, the economic impacts of which may, in any event, be debatable, some obvious comments seem suggested both by collaborative or consultative structures elsewhere and by elementary lessons from game theory. In seeking cooperative accords between federal and provincial governments, in industrial policy, as in other policy areas, comparative experience and basic precepts of game theory (Axelrod, 1984) imply that institutional arrangements which emphasize constrained agendas of issues, limited numbers of players, repeat players with long-term involvements in the issues, and a regular cycle of interactions are more likely to achieve cooperative outcomes than are arrangements lacking these features. Federal-provincial structures might, for example, focus on negotiating accords pertaining to certain well-defined classes of inter-provincial barriers to trade. Such structures would presumably involve senior representatives of government who meet reg-

TABLE 9-15 Alternative Central Government Objective Functions

Maximize national output.

Maximize national output, subject to the constraint

- a) that there be a minimum level of income for all Canadians.

Maximize national output, subject to the constraints

- a) above and
- b) that regional income disparities be narrowed.

Maximize national output subject to the constraints

- a) and b) and, further,
- c) that provincial income disparities be narrowed.

Maximize national output subject to the constraints

- a) and
- d) that regional production disparities be reduced.

Maximize national output subject to the constraints

- a) and d) and, further,
 - e) that provincial production disparities be narrowed.
-

Source: Thomas J. Courchene, "Analytical Perspectives on the Canadian Economic Union," in *Federalism and the Canadian Economic Union*, edited by M.J. Trebilcock et al. (Toronto: Ontario Economic Council, 1983), p. 99.

ularly and privately, who enjoy some permanency of tenure, and who possess some professional or technocratic expertise in the subject area which tempers transitory considerations of political expediency which might otherwise dominate decision making. They would therefore seem to hold out more promise than occasional federal-provincial first ministers' meetings on the state of the economy at large. Similarly, bilateral agreements between federal and provincial governments, such as the General Adjustment Agreements, which might concert adjustment policies for a given sector, reduce the bargaining costs otherwise entailed in multilateral relations (Trebilcock, 1985).

While federal-provincial relations have come to dominate so much of policy making in Canada (probably largely unavoidably, given our constitutional structure and regional diversity), they have equally undoubtedly come to do so at a cost. These relations emphasize what Simeon (1980) calls "vertical" or territorial divisions within the country and conflicts over the spatial or geographic allocation of resources. Table 9-15 presents Courchene's ordering of alternative central government objective functions.

These objectives are ordered so that the level of national income is likely to fall as one moves down the list. The proposals in this concluding chapter attempt to direct more emphasis to the second option by focusing more strongly on the welfare of *individuals* rather than on that of firms or regions and even then to emphasize adjustment assistance rather than mere unconditional compensation for income deficiencies.

In several major members of the Organization for Economic Cooperation and Development (OECD) such as West Germany and the Scandinavian countries, much more attention is devoted than is given in Canada to reconciling horizontal rather than vertical divisions, particularly among producer interests, especially labour and capital. While corporatism, tripartitism, or social contract theories in the mould of the West German and Scandinavian models may not be readily reproducible in Canada, it seems highly desirable to implement some much more systematic form of interaction between the national government and national labour and business interests in the economic policy-making field than the present process of ad hoc and separate consultation. A deliberative structure of this kind might tend to internalize the costs of favoured policies to a greater extent than narrow special interest groups are likely to do or than political parties *per se*, where voters and interest groups typically lack the organized format of regular interactions among repeat players in the formation of policy preferences to ensure cooperative outcomes or the development of information networks required to evaluate fully the likely impact on their interests of alternative policies. Producers — capital and labour — are, of course, keenly interested in the way in which the gains and pains of adjustment are to be shared, but they also share a common and well-defined interest in increasing the net wealth to be shared. Following closely the simple game-theory precepts noted above (constrained agendas, limited number of players, repeat players, regular interactions), some institutional structure where representatives of the national government can meet on a regular basis with national representatives of labour and business to share information about the present state of the economy, forecasts of future trends, current difficulties in particular sectors, and implications of alternative policy options, may have economic advantages. Such a consultative structure is likely to provide the federal government with perspectives on policy making in the industrial policy field that are unlikely to be revealed in federal-provincial government relations with their more diffused foci, and to assist the federal government to identify and over time, perhaps, to help shape some margins for policy development that address not only the sharing of existing economic wealth, but also the enhancement of Canada's future economic well-being. Such a structure must, of course, be national in its perspective and must avoid the narrow industry-specific focus entailed in the Tier I and Tier II industry-review committees set up by the Department of Industry, Trade and Commerce in the 1970s, where management and labour from the sectors concerned simply produced wish-lists of government favours for their sectors. The British experience with mini-tripartite bodies (Sectoral Working Parties) set up under the aegis of the National Economic Development Council appears to have been similarly unproductive. This is not to say that a *national* deliberative structure of government, business and labour could

not profitably consult with particular business and labour interests when reviewing sector-specific problems, but this practice must be distinguished from abdicating policy-formation initiatives to such interests. Whatever the structure, the government cannot afford to be ambivalent in its general policy orientation if these deliberative mechanisms are to retain a constructive and coherent adjustment focus.

Central to this focus is the avoidance of regional and industrial policies that create excessive state dependencies relative to underlying economic forces. So, too, where dependencies have arisen as a result of major shifts in underlying economic forces, is the adoption of policies that subsidize the dissipation of those dependencies rather than their perpetuation. These would include labour-adjustment policies that encourage reallocation of resources. The concept of conditionality is vital to this orientation. The proposals here advanced have advocated imposing conditions on every form of trade-protection measures, industrial subsidies (if these two policies cannot be avoided), and labour-assistance programs to ensure that the beneficiaries adopt some course of action that will change their economic status and thus reduce their dependence on future state support. In addition, diversification is highly important in the range of judgments brought to bear on alternative economic opportunities, to avoid excessive reliance on monolithic (and possibly mistaken) judgments by the state concerning appropriate strategies for the redeployment of redundant capital and labour. Finally, it must be re-emphasized that the effectiveness of a country's adjustment policies must be judged on how *rapidly* they enable adjustment to changes in underlying economic forces, not on how successful they are in *postponing* the process of adjustment. So far, many, if not most, of Canada's so-called "adjustment" policies have been successful only if judged according to the latter criterion. But in an era of increasing international competitiveness and rapid technological change, dynamic growth strategies require dynamic adjustment policies. The economic and ultimately political costs of antithetic policies are likely to be much larger in the future than they have been in the past.

Notes

CHAPTER 1

1. Brenner and Courville (1985). See more generally Brenner (1983).
2. See Nedelsky (1984).
3. See Buchanan (1959).
4. For useful discussions of distinctions between the Pareto principle, utilitarianism and wealth maximization, see Kronman (1980) and Coleman (1980).
5. On all of these bankruptcy issues, see Trebilcock et al. (forthcoming).
6. Ibid.
7. See Trebilcock and Quinn (1979).
8. See Zerbe and Cooper (1982).
9. See Trebilcock and Quinn (1979).
10. See Rees and Foster (1981).
11. See Trebilcock et al. (forthcoming).
12. See generally Becker (1964).
13. See Reid and Meltz (1979); Kaliski (1984).
14. See Courchene (1984b).
15. See, for example, Walzer (1983).
16. See Kaplow (1985).
17. See Baldwin (1982); Green (1984) and references therein.
18. See Trebilcock et al. (1983); Thorburn (1984); Jenkin (1983); Simeon (1980); Flatters and Lipsey (1983).
19. See Green (1984).
20. See Chandler and Trebilcock (1985, chap. 9).
21. Taken from United States (1983, Table 7).
22. See generally on these issues, Pearson and Salembier (1983, chap. 2).
23. See Hillman (1982).
24. See Chandler and Trebilcock (1985, chap. 9).
25. Robert Reich, "Book Review of M. Olson, *The Rise and Decline of Nations*," *New Republic* (December 1983).

CHAPTER 2

1. Doern and Phidd (1983, chap. 15); Thorburn (1984); Jenkin (1983); French (1980); Trebilcock et al. (forthcoming, chap. 8).
2. For example, Olson (1982); Zysman (1983); Katzenstein (1978a).
3. Doern and Phidd (1983); Jenkin (1983); Thorburn (1984); Trebilcock et al. (forthcoming, chap. 8); Zysman (1983).
4. Doern and Phidd (1983); Thorburn (1984); Jenkin (1983); French (1980).
5. One should note that the following sections on job-training programs, national training and mobility programs draw heavily on Saunders (1984).
6. Saunders (1984, p. 40) also follows this course in his analysis of the 1981 study's results.
7. See table at p. 2-57 of study.
8. Dominion Bureau of Statistics (1957, pp. 16-19; 1968, pp. 24-27); Statistics Canada (1977, pp. 4-7; 1982, pp. 4-7; 1984, pp. 4-7).
9. CSSRA (1984a, p. 7); Mr. Henry Walsh, President, CSSRA.
10. Section 3(4)(b) of P.C. 1970-2198, SOR/71-72, p. 26.
11. Section 3(4)(a) of P.C. 1970-2198, SOR/71-72, p. 26.
12. Compiled from DEVCO's Annual Reports.
13. Ibid.

CHAPTER 3

1. *Wall Street Journal*, August 16, 1983, cited in Richardson (1984, p. 4).
2. *Newsweek*, March 2, 1981, p. 29.
3. *Ibid.*
4. United States (1977d), cited in Rosenblatt (1977, pp. 1080–83).
5. United States (1977c), cited in Rosenblatt (1977, p. 1077).
6. Adapted from statistics presented in Yoffie (1983, p. 325).
7. United States (1978a), cited in Ramseyer (1981, p. 601).
8. *Time Magazine*, November 30, 1981, p. 64, cited in Borrus (1983, p. 99).
9. Kathy Utgoof, Public Research Institute of the Center for Naval Analyses, cited in Richardson (1984, p. 6).
10. *Newsweek*, March 2, 1981, p. 29.
11. Piper, Marshall, and Merrill (1977), cited in Borrus (1983, p. 79).
12. The *Antidumping Act* is intended to prevent a foreign exporter from practising price discrimination between the home market and the U.S. market. The Act stipulates that the foreign producer cannot sell in the United States below his home-market prices.
13. The Solomon Program, pp. 7–8, cited in Borrus (1983, p. 94). Objectives of the Solomon Program:
 - (1) to assist the steel industry in a manner which will stimulate efficiency and enable the industry to compete fairly;
 - (2) to ease the burden of adjustment trends for both industry and labor;
 - (3) to provide meaningful incentives for plant and equipment modernization through tax, investment and financial assistance;
 - (4) to expedite relief from import competition, but to do so in a manner which will . . . be consistent with [the] overall objective of maintaining an open world trading environment based on normal trading practices; and (a) to avoid any direct government involvement in the industry's decisions; (b) to avoid any measures which stimulate inflation.
14. Reich (1983, p. 184): the TPM costs American consumers more than \$1 billion annually in the form of higher prices for products which contain steel. American firms which use steel must pay 25 to 35 percent more for steel than their European and Japanese competition.
15. United States, (1978b, p. 7), cited in Aggarwal and Haggard (1983, p. 258).
16. Solomon Barkin, Director of Research of the United Textile Workers of America, before the 1958 Hearings by the Subcommittee on Interstate and Foreign Commerce of the United States Senate, chaired by Senator Pastore and held intermittently from 1956 to 1968, cited in Aggarwal and Haggard (1983, p. 268).
17. P. Handel and M.P. Daniels, "Politics, Protection, and Domestic Industry," a position presented on behalf of the American Importers Association before the Senate Subcommittee on Trade, July 21, 1980, cited in Aggarwal and Haggard (1983, p. 310).
18. Yoffie (1983, p. 323). In 1973, 49 percent of manufacturing was in the Northwest and Atlantic, and was concentrated in New York and Massachusetts.

CHAPTER 4

1. Grant and Wilks (1983, p. 23); see also Fleming (1980, p. 141).
2. Anthony Wedgewood Benn, quoted in Fleming (1980, p. 144).
3. Derived from Rhys (1980, p. 186, Table 8.4).
4. Derived from Pollard (1983, p. 289, Table 7.10).
5. Derived from Cottrell (1981, p. 60, Table 27).
6. *Ibid.*, p. 65, Table 30.
7. Sir Charles Villiers, in OECD (1980, pp. 200–205).
8. *Globe and Mail*, July 9, 1985, p. B13.

9. Griffin (1977, p. 176) for years 1960 to 1972–73.
10. For example, under the 1967 and 1981 *Coal Industry Acts*.
11. For example, under the 1965, 1967 and 1981 *Coal Industry Acts*, and in 1971–72 and 1973–74, to offset deficits caused by strikes.
12. For example, under the 1965 *Coal Industry Act*, and following the 1972 strike.
13. For example, coal imports were restricted in the early 1960s and under the 1981 *Coal Industry Act*.
14. For example, under the 1961 budget.
15. For example, under the 1965 and 1967 *Coal Industry Acts*, after the 1972 strike and in 1978–79.

CHAPTER 5

1. Treasurer of Australia, Press Release No. 142: "Partial Participation of Banking in Australian and Other Issues of Financial Deregulation," September 10, 1984.
2. *Ibid.*, p. 2.
3. Industrial Assistance Commission 1975–76 Annual Report, cited in Bulbeck (1983, p. 230).

CHAPTER 6

1. Quinn (forthcoming). The data for Canada are taken from the Canada Year Book (Statistics Canada, 1981, p. 285).

CHAPTER 7

1. *The Economist*, September 23, 1978, p. 95.
2. *The Economist*, July 16, 1983, p. 86.
3. *Ibid.*
4. *Maclean's*, March 2, 1984, p. 56.

CHAPTER 8

1. See Trebilcock et al. (forthcoming).
2. As described in Magaziner and Reich (1983, p. 274).
3. *Business Week*, October 26, 1981.
4. These mergers had not been government assisted; see Stegemann (1979, pp. 462–79).
5. *The Economist*, October 2, 1982, p. 49.
6. *Ibid.*

CHAPTER 9

1. See Harris, Lewis, and Purvis (1984, pp. 89–90).
2. See Lipsey (forthcoming).
3. See United States (1983, Table 7).
4. See Protheroe (1980, Chap. 4).
5. See Trebilcock and Engelhart (1981).
6. See Trebilcock et al. (forthcoming).
7. *Ibid.*
8. See Olson (1982); Zysman (1983); Dyson and Wilks (1983a); Chandler and Trebilcock (1985); and McCallum and Blais (1985).

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